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TRANSCRIPT OF RECORD.

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1914.

No. [redacted] 359

JOHN R. STANTON, APPELLANT,

vs.

BALTIC MINING COMPANY ET AL.

APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF MASSACHUSETTS.

FILED FEBRUARY 24, 1915.

(24,572)

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INDEX.

JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., MARCH 8, 1915.

a District Court of the United States, District of Massachusetts.

No. 609. In Equity.

JOHN R. STANTON, Original Complainant, Appellant,
v.
BALTIC MINING COMPANY et al., Original Defendants, Appellees.

Transcript of Record.

1 Transcript of Record of District Court.

UNITED STATES OF AMERICA,
Massachusetts District, ss:

At a District Court of the United States begun and holden at Boston, within and for the District of Massachusetts, on the first Tuesday of December, being the first day of December, in the year of our Lord one thousand nine hundred and fourteen.

Before the Honorable James M. Morton, Jr., District Judge.

No. 609. Equity Docket.

JOHN R. STANTON, Complainant,
v.
BALTIC MINING COMPANY et al., Defendants.

The Bill of Complaint in this cause is filed in the clerk's office on the tenth day of February, A. D. 1915, and is duly entered at the present December Term of this Court, A. D. 1914, and is in the words and figures following:

2 *Bill of Complaint.*

(Filed February 10, 1915.)

To the Judges of the District Court of the United States for the District of Massachusetts:

John R. Stanton, a citizen and resident of the city and State of New York, brings this bill of complaint against the Baltic Mining Company, a corporation duly established and existing under the laws of the State of Michigan and a citizen of said State of Michigan and having its office and residing in the city of Boston, in the Commonwealth and District of Massachusetts; William A. Paine, a citizen of said Commonwealth and resident in said Boston, President and Director of the said Baltic Mining Company; Frederic Stan-

wood, a citizen of said Commonwealth and resident in Brookline therein, treasurer and director of the said Baltic Mining Company; and Samuel L. Smith, a citizen of said State of Michigan and resident in Detroit therein; Thomas S. Dee, a citizen of said Commonwealth and resident in Boston therein; and F. Ward Paine, a citizen of said State of Michigan and resident in Houghton therein; directors of said Baltic Mining Company.

And thereupon your orator complains and says as follows:

3 First. That the complainant herein is and for many years has been a stockholder in the Baltic Mining Company, one of the respondents herein, holding and owning thirty-six (36) shares therein, of the value of more than Three Thousand (3,000) Dollars.

Second. That the total capital stock of the respondent company already issued and outstanding amounts to $2,500,000, divided into 100,000 shares of the par value of $25. each.

Third. That the respondent company is a mining company, being chartered and organized for the purpose of engaging in and carrying on the business of mining, refining and smelting copper and copper ores and minerals containing copper and copper ores and manufacturing the same.

That a large percentage, namely, over 99 per cent of the shares in the respondent company, is owned and held by the Copper Range Consolidated Company, a corporation established under the laws of the State of New Jersey, and taxable under the Income Tax law, for income through large dividends received from the respondent company.

Fourth. That the respondent company owns and operates a copper mine located in said State of Michigan.

That on the 30th day of March, 1911 an official estimate was made and filed by the officers of the respondent company, as to the amount of the known copper deposits in said mine and their fair market value, as of the date of January 1, 1909, pursuant to the Regulations and Instructions of the Commissioner of Internal Revenue issued under date of February 14, 1911, relative to the Special United States excise tax on corporations imposed by Section 38 of the Act of August 5, 1909.

That the said estimate covered the fair market value, as of January 1, 1909, of the pure copper then known to be deposited in said mine, in the form of unmined copper ore or mineral, upon the basis of the disposal value of such copper deposits en bloc, and exclusive of the value of improvements and development work.

That said estimate included no copper whatsoever except deposits already discovered and marked out and included no future discoveries made or to be made after January 1, 1909 of copper deposits then unknown.

That the said official estimate, as your complainant alleges upon information and belief, in a fair and correct estimate and the facts therein stated are true, as your complainant alleges and believes.

That in said estimate the value of pure copper, during the 40 year life of said mine, is reckoned at 15 cents per pound; that the

present value of copper is approximately that price; that the average price of copper during the past thirty years has been over 15 cents per pound.

That the facts hereinafter stated,, with respect to the amount of unmined deposits in said mine, the fair disposal value thereof en bloc, the life of said mine, the average yearly production thereof, the cost of production, the average yearly net receipts and the respective proportions of such net receipts which represent the return of invested capital, and income or profit from the investment, all refer to the 40 year estimated life of said mine, beginning with January 1, 1909, and are derived from the facts and estimates contained in the said official estimate filed with the records of the respondent company.

That said mine, according to said estimate, was valued, at its fair value, at $28,000,000 and is now of such value, less such proportionate amount of its total deposits as may have been extracted in the past six years.

That, according to said estimate, the said mine contains deposits of unmined copper ore, sufficient, if mined and extracted, to produce a yearly output of 20,000,000 pounds of pure refined copper, during the term of 40 years, the estimated life of said mine, and of the net yearly value of $1,400,000, over and above the total average cost of 8 cents per pound for mining, extracting, refining and selling the same.

That the said company has an approximate investment of $2,000,000 in plant and equipment, which, however, constitutes less than 10% of the total value of its assets, the remaining 90% or more consisting of the said copper mine and the unmined ore deposits therein.

4 Fifth. That the respondent company according to said estimate, is mining copper ore from its said mine and crushing, smelting and converting the same into pure refined copper at an approximate rate of 20,000,000 pounds per annum, which is and will be, during the forty-year life of said mine, as your orator charges and believes, the fair average yearly output.

That the total deposits of copper ore in the said company's mine aggregate approximately 800,000,000 pounds of pure copper, if and when mined, extracted and refined. Such deposits represent and constitute the capital or principal of the investment made by the said company, outside of its plant and equipment.

That the extraction and depletion of said deposits represent a constant diminution pro tanto of the capital or investment.

That the net receipts, above expenses, realized from the sale of the company's annual product, represent and constitute, to the extent of one-half or more of the entire net receipts, a realization into money of a constantly diminishing capital or investment consisting originally of the unmined deposits of copper ore.

That in the copper mining business such net receipts also include and represent another, but much less important element, namely, the annual depreciation or replacement, at the rate of 5%, of the capital, amounting to $2,000,000, invested in the machinery and

plant required for the purpose of extracting the product from the ground during the life of the mine, and thereafter becoming practically worthless for mining or other uses.

That out of the entire yearly net receipts of said company, whether more or less than the average amount of $1,400,000, $100,000, or seven per cent thereof, is required for and represents the yearly depreciation of its machinery and plant, and approximately $750,000, or fifty-three per cent thereof, represents nothing but the depletion of capital caused by removal of ore deposits, and does not represent or include any amount whatsoever of income derived by the respondent company.

5 That only the remainder, or approximately 40 per cent of the respondent company's net receipts over and above the total deductions, as aforesaid, of $850,000 per annum, represents the company's net income derived from all sources, whether from manufacturing, mining, selling or otherwise.

Sixth. That the gross output of the respondent company, at its fair average price and rate of production, during the life of said mine, yields and will yield gross receipts amounting to $3,000,000 per annum or thereabouts.

That the net receipts of said company, after deducting the entire expenses of production and sale of its copper during the life of said mine, amount and will amount to $1,400,000. per annnm or thereabouts.

That the sum of $750,000, per annum, or 53 per cent of the entire net receipts, exclusively represents a constantly diminishing principal until, at the end of its 40 year life, the mine is exhausted and the capital has completely disappeared.

Seventh. That although $750,000 per annum, out of the respondent company's net receipts, represents depreciation and depletion of capital assets and consequently losses of capital, the respondent company is arbitrarily limited, under the Income Tax law, to deducting $150,000. per annum, that is, 5% of its gross annual output, valued at $3,000,000. The respondent company is, accordingly, limited to deducting one-fifth of its actual annual losses through depletion of its ore deposits; whereas, under said Income Tax law, all other classes of corporations and all individuals not owning mines are allowed to deduct their full actual losses by depreciation or depletion of capital assets.

The tax on the difference between the arbitrary allowance of $150,000 and the real losses of $750,000, through depletion of capital assets, is a tax on capital, and not upon income.

That, in the case of mines, the annual gross output represents, to a large extent, the withdrawal or loss of capital assets., is demonstrated more forcibly in the case of mines of a shorter life.

Assuming that a mine is purchased for $500,000, and its entire ore deposits, aggregating $1,500,000 in value, can be mined in a single year, at an operating cost of $500,000, the result is plain that the capital of $500,000 has been returned and withdrawn and a profit or income of $500,000 has been realized.

The same principle applies equally to mines, whatever may be their length of life.

That the provision as to allowances for depletion of ore supplies, under said Income Tax law, further discriminates arbitrarily against mining companies, in that the said law, as administered under the Income Tax Regulations issued by the Commissioner, limits such allowances to a percentage on the actual cost of the properties containing such deposits; whereas the actual cost of the respondent company's mine was only one-twenty-eighth part, or thereabouts, of the real value of said mine on January 1, 1909, or at the date of passage of said Income Tax law, or at the present time; and Whereas all other classes of corporations and all individuals not owning mines are entitled to deduct a fair depreciation based on the actual value of their property, and not based solely upon its original cost.

That the real or actual yearly income derived by the respondent company from its business or property, does not exceed $550,000. That, under the Income Tax, the said company is held taxable, in an average year, to the amount of approximately $1,150,000, the same being ascertained by deducting from its net receipts of $1,400,000 only a depreciation of $100,000 on its plant and a depletion of its ore supply limited by law to 5% of the value of its annual gross receipts and amounting to $150,000; whereas, in order properly to ascertain its actual income $750,000 per annum should be allowed to be deducted for such depletion, or five times the amount actually allowed.

Accordingly, the said company is held taxable on double its real or actual income, the difference between the actual income of $550,000 and the taxable amount of $1,150,000 representing a part of the company's capital and property investment, which is thus taxed, under said Income Tax, as if it were income, instead of capital.

6 Eighth. That by Paragraph G (*a*) of Section 2 of the Act of Congress of October 3, 1913, known as the "Income Tax law," it is provided that the normal tax of 1 per cent imposed annually upon individuals, under said Income Tax law, shall likewise be levied, assessed and paid annually upon the entire net income arising or accruing from all sources during the preceding calendar year to every corporation, joint-stock company or association, and every insurance company, organized in the United States, no matter how created or organized, not including partnerships, and thus including mining companies and the respondent company, and providing certain exemptions from said taxes, as therein stated.

That by said Income Tax law all other classes of corporations, except mining companies and mines, are allowed, under Paragraph G (*b*) of said Section 2, for the purpose of ascertaining their taxable net income, to deduct from their gross receipts (1) all the ordinary and necessary expenses paid within the year in the maintenance and operation of their business and properties and (2) all losses actually sustained by them within the taxable year and not compensated by insurance or otherwise, "including a reasonable allowance for depreciation by use, wear and tear of property, if any;" Whereas, in

the case of mines and mining companies, it is therein provided that they are limited to deducting a reasonable allowance for depreciation, by way of depletion of their ores, not exceeding 5 per cent of the "gross value at the mine of the output" for the year for which the computation of taxable net income is made.

Ninth. That, in view of the forty-year life of said mine, at an annual output of 20,000,000 pounds of pure copper, the capital and investment represented by the total ore deposits is extracted at the rate of 1/40 of such deposits per annum.

The "gross value at the mine" of the annual output is or averages to be 1/40 of the gross value of the capital and investment represented by the total ore deposits, whatever such value may happen to be.

7 The 5% allowance for depreciation, by way of depletion of ore deposits, allowed by the Income Tax law, to said company, amounts, accordingly, to an annual allowance of 1/20 part of 1/40 or 1/800 of the gross value of the capital and investment represented by the total ore deposits. It also represents, as your complainant alleges and believes, approximately 1/200 of the present fair market value of such capital and property investment if disposed of en bloc at the present time, instead of in annual instalments during a period of 40 years.

That a fair average annual depreciation, as allowed to all other classes of corporations and to all individuals, except those owning mines, for the use, wear and tear of their plants, capital or property investments, under the said Income Tax law, ordinarily amounts to 5% or 1/20 of their capital.

That the arbitrarily fixed and limited depreciation, by way of depletion of their ore supplies, allowed, under said Income Tax law, to mining companies, by thus allowing to them 1/200 to 1/800 of their capital, whereas all other classes of corporations are allowed to deduct for annual depreciation 1/20 of their capital invested in plant, machinery or other depreciating property, constitutes an arbitrary discrimination against mining companies and in favor of all other classes of corporations.

Tenth. That, under and by virtue of the alleged authority contained in said Income Tax law, if valid and constitutional, the respondent company is taxable at the rate of 1 per cent upon its gross receipts from all sources, during the calendar year ending December 31, 1914, after deducting (1) its ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties and (2) all losses actually sustained within the year and not compensated by insurance or otherwise, including depreciation arising from depletion of its ore deposits to the limited extent of 5% of the "gross value at the mine of the output" during said year.

8 That under the alleged authority contained in Paragraph G, Sub-Section (*c*), of said Income Tax law, if valid and constitutional the respondent company, on or before the first day of March, 1915, is required to render a true and accurate return under the oath or affirmation of its President, Vice-President, or other prin-

cipal officer, and its Treasurer or Assistant Treasurer, to the Collector of Internal Revenue for the Third District of Massachusetts, where it has its principal place of business, setting forth the facts required by said Sub-Section (*c*) and the amount for which it is taxable under said law, including a statement of the total amount of all losses actually sustained by it during the year and not compensated by insurance or otherwise, stating separately any amounts allowed for depreciation of property.

Eleventh. That, by virtue of the laws of the State of Michigan and the by-laws of the respondent company, the management of its property and affairs is committed to its Board of Directors. That under the alleged authority of said Income Tax law, the respondent company is liable to pay and the respondent directors of said company intend to cause to be paid to the Commissioner of Internal Revenue for the United States of America, for the use of the said United States, on or before the 30th day of June 1915 a tax of 1% for the year ending December 31, 1914 and on or before the 30th day of June in each year thereafter a tax of 1% for each year ending December 31 thereafter, upon the entire "net income", so-called, of the respondent company received by it from all sources during such year or years, and consisting of its entire gross receipts, deducting the expenses of operation and maintenance and depreciation, by way of depletion of ore deposits, only to the extent of 5% of the gross value at the mine of the year's output of copper.

Twelfth. And your orator further represents that the said Income Tax law, as well as the said Sub-Section G (*b*) covering the depreciation of mines, are unconstitutional and void, under the Federal Constitution, as applied to the respondent company or
9 to mines, for the following reasons, viz:—

(1) Because said Income Tax law arbitrarily, and without proper reason or classification, discriminates against mining companies, and in favor of all other kinds of corporations and all individuals not owning mines, with respect to the kind and amount of depreciation allowed to be deducted in ascertaining net income, by allowing all other classes of corporations and all such individuals to deduct a fair and reasonable percentage for depreciation and losses of their capital, whereas mines and mining companies are arbitrarily and unreasonably forbiden so to do and are absolutely restricted to a basis for deduction having no material bearing upon their real losses and depreciation, and amounting only to 5% of their gross income, thereby taxing mining companies in this respect much more severely (in the case of respondent company ten times more so) than all other classes of corporations or individuals not owning mines.

That by such arbitrary discrimination mining companies, including the respondent company, and their stockholders are deprived of their property without due process of law, in violation of the Fifth Amendment to the Federal Constitution.

(2) Because the special provisions of said Income Tax law contained in said Sub-Section G (*b*), in so far as they arbitrarily impose on mining companies and mines particularly onerous con-

ditions, with respect to depreciation and depletion of ore supplies, which are not at the same time applied to any other classes of corporations or to any individuals not owning mines, are unconstitutional and void under the Fifth Amendment, in that they deny to mining companies and their stockholders equal protection of the laws and deprive them of their property without due process of law.

(3) Because the 16th Amendment authorizes only a tax upon incomes. This tax, as applied to mines, is a tax on capital and property, and not upon incomes, because the actual losses and the fair depreciation, by way of depletion of ores, are not allowed to be deducted from the gross receipts.

10 Being a tax upon capital and property, in so far as the actual net income is not attempted to be reached by proper deductions from the gross receipts, the said Income Tax law, as applied to mining companies, is a direct tax on property, and, therefore, is unconstitutional and void, because it is in violation of Clause 3 of Section 2 of Article 1 of the Federal Constitution, providing that direct taxes shall be apportioned among the several States according to their respective numbers, and also because it is in violation of Clause 4 of Section 9 of Article 1 of the Federal Constitution, providing that no capitation or other direct tax shall be laid by Congress unless in proportion to the census or enumeration in said Constitution directed to be taken.

(4) Because the said Income Tax unlawfully classifies and discriminates between corporations or individuals not owning mines and companies or individuals owning mines, by taxing the net income of the former class and by taxing, in substance and effect, the gross receipts of the latter class, irrespective of their net income (the deduction from gross receipts allowed by the Act being wholly insignificant and negligible, as applied to mining companies), and, accordingly, denies to mining companies equal protection of the laws, in contravention of the Fifth Amendment.

(5) Because the said Income Tax law further discriminates unlawfully against mining companies, in that said companies are limited to a deduction for depreciation based on the actual cost of their mines, under said law as administered under the Income Tax Regulations issued by the Commissioner of Internal Revenue; Whereas all other classes of corporations are allowed to deduct the real depreciation of their property based on its fair value, instead of its actual original cost.

Such arbitrary discrimination is unconstitutional, because it contravenes due process of law, as guaranteed by the 5th Amendment.

(6) Because, under the special excise tax for January and February 1913, levied by Section 4 Paragraph S, of said Act of October 3, 1913, mining companies are unlawfully discriminated against, in favor of all other classes of companies, in that all, except mining corporations, have their excise measured by their net income, in continuation of the provisions of the former excise tax of August 5, 1909;

Whereas, the excise of mining companies is measured, in effect, by their gross receipts; and whereas mining companies are thereby

subjected to a new and discriminatory method of taxation not employed against other classes of corporations, and covering a period already expired prior to the passage of the 16th Amendment, although their excise had already accrued for such period under the former law imposing a less onerous method of taxation, and thereby mining companies are denied equal protection of the laws and deprived of their property without due process of law, in violation of the Fifth Amendment.

(7) Because said Income Tax law is grossly unfair and unequal and denies the equal protection of the laws and due process of law guaranteed by the Fifth Amendment, in that it levies double taxation, when applied to holding companies, like the Copper Range Consolidated Company, the owner of 99 per cent of the capital stock of the respondent mining company, the income of which is, in effect, taxed twice in such a case (1) in the form of its own income (2) in the shape of dividends paid by it to the holding company.

(8) Because said Income Tax law unlawfully discriminates between individuals and corporations, in that individuals having incomes in excess of $20,000 are made subject to a surtax thereon of from 1 to 6 per cent additional taxes, whereas corporations having incomes in excess of $20,000 pay nothing beyond the normal tax of 1% on their income, such discrimination being in violation of equal protection of the laws, and due process of law, as guaranteed by the Fifth Amendment.

11 (9) Because the exemptions, under said Income Tax law, of individual incomes below $4,000, of incomes of labor organizations and various other exemptions therein set forth are manifestly arbitrary, unfair, discriminatory and unconstitutional, in that they deny the equal protection of the laws and due process of law guaranteed by the Fifth Amendment.

Thirteenth. That the complainant has requested the respondent company, its officers and directors, to refrain from filing the required return, or any return, under the provisions of said Income Tax law, with the Collector of Internal Revenue for the Third District of Massachusetts and to refrain from paying any tax upon net income under said law.

The complainant alleges that such returns and such payments should not be made, unless and until the actual net income of the respondent company shall be ascertained and computed, by proper deduction for depreciation, losses and depletion, in the same manner as the Income of all other corporations (except mining companies) and all individuals not owning mines is ascertained and computed and unless and until it shall be declared constitutional to tax the respondent company practically upon its entire gross receipts, as provided in Sub-section G (*b*), of said law, while taxing all other kinds of corporations (except mining companies) only upon their net income.

A copy of your orator's letter, written by his duly authorized attorney, to the respondent Paine, President of the respondent company, is hereto attached and marked "A".

A copy of the reply thereto of the said Paine, as such President, is hereto annexed marked "B".

Fourteenth. That the respondent directors have duly voted and determined to comply with all and singular the provisions of said Income Tax law, by causing the President and Treasurer of the respondent company to make its return to said Collector of Internal Revenue, as required by said law, on or before March 1, 1915, and by causing to be paid on or before June 30, 1915, to the Commissioner of Internal Revenue, for the use of the United States, the said tax alleged to be assessable upon the income of the respondent company, for the calendar year ending December 31, 1914, computed in the manner above set forth and as provided by said Income Tax law.

Fifteenth. That if the respondent directors shall cause the respondent company to pay the said tax out of its gains, income and profits, as they have proposed and declared their intention of doing, they will diminish the assets of the respondent company and lessen the dividends to be derived from its shares by its shareholders, and will thereby lessen the value of said shares; and that a voluntary compliance with the provisions of said Income Tax law, will subject the assets and property of the respondent company to great and irreparable damage, to the great and irreparable damage of your orator and all the shareholders in the respondent company.

That the capital stock of the respondent company is divided among a number of persons as shareholders therein, and that this bill is filed for an object common to all of said shareholders,
12 and your orator, therefore, brings this bill not only in his own behalf as a shareholder in the respondent company, but also as a representative and in behalf of such of the other shareholders therein similarly situated as may from time to time choose to intervene and become parties to this bill.

Sixteenth. That your complainant is the owner and registered holder of thirty-six (36) shares of the capital stock of the respondent company of a value exceeding $3,000; that he has been a stockholder, to the same or a larger extent, ever since the organization of said company and that this suit is not a collusive one to confer on a court of the United States jurisdiction of a case of which it would not otherwise have cognizance.

Seventeenth. And your orator further represents that this is a suit of a civil nature in equity; that the matter in dispute exceeds, exclusive of costs, the sum of two thousand dollars; that said suit arises under the Constitution and laws of the United States; and that said suit is, furthermore, a controversy between citizens of different States.

Wherefore your orator prays:—

1. That it may be decreed that the provisions of Sub-section G (*b*) of said Income Tax law, limiting mines to an allowance for depletion of ores, amounting only to 5% of the gross value at the mine of the yearly output, are unconstitutional and void, as applied to mining companies, including the respondent company, because they contravene the Federal Constitution in the manner above set forth.

2. That it may be decreed that the said Income Tax law, is unconstitutional and void, in so far as it applies to mining companies, including the respondent company, for the reasons above set forth.

3. That each and all of the respondents may be perpetually restrained from complying with the provisions of said Income
13 Tax law, by making or rendering any lists, returns or statements, for the calendar year 1914, or for any subsequent year, to the Collector of Internal Revenue for the Third District of Massachusetts.

4. That each and all of the respondents may be perpetually restrained from complying with the provisions of said Income Tax law, by paying to the Commissioner of Internal Revenue on or before June 30, 1915, or at any other time any tax of 1% upon the income of the respondent company for the year ending December 31, 1914, or for any subsequent year, as computed or required under authority of said Income Tax law.

5. That your orator may have such other and further relief in the premises as justice and equity may require and to your Honors shall seem meet.

JOHN R. STANTON,
By his Solicitor, CHARLES A. SNOW.

CHARLES A. SNOW,
Counsel and Solicitor for Complainant.

14 "A."

Boston, Mass., January 28th, 1915.

Mr. William A. Paine, Pres't Baltic Mining Co., 82 Devonshire St., Boston, Mass.

Dear Sir: I write, as counsel for and in behalf of Mr. John R. Stanton of New York City, the owner and holder of 36 shares in the capital stock of your company, to object to the payment by your company of any tax under the Income Tax law, (Section 2 of Act of Congress of October 3, 1913), and further to object to the filing of any returns by the officers of your company with the Collector of Internal Revenue for this District, because, in my judgment, the said Income Tax law is unconstitutional, as applied to mining companies, because it arbitrarily discriminates between mining companies and all other classes of corporations with respect to allowances for depreciation and depletion of ores, in violation of the 5th Amendment, and for other reasons.

I request your company, its officers and directors, to refrain from filing any such returns and from paying any such taxes.

I respectfully request that you will take up this matter at the next meeting of your Board of Directors and present my letter for the action of the Directors thereon.

Will you kindly advise me, at your earliest convenience, what will be the intention and attitude of your directors regarding payment of the tax for the calendar year ending December 31, 1914, due on

or before June 30, 1913 and the filing of returns due on or before March 1, 1915 for said calendar year.

Very truly yours.

(Signed) CHARLES A. SNOW.

15 "B."

BOSTON, January 30, 1915.

Charles A. Snow, Esq., 50 Ames B'ld'g, Boston, Mass.

DEAR SIR: Yours of the 28th inst. received, in which, on behalf of Mr. John R. Stanton, a stockholder in this company, you request this company, its officers and directors to refrain from filing any returns or paying any taxes under the Federal Income Tax Act of October 3, 1913, because of the alleged unconstitutionality of said Act.

I desire to inform you, in compliance with your request, that this matter and your letter were fully considered at a meeting of the Board of Directors held this day and thereupon our directors passed the following vote:

"Voted to instruct the officers of this company to file the returns, for the calendar year ending December 31, 1914, with the Collector of Internal Revenue for the Third District of Massachusettts on or before March 1st 1915, and to pay the tax assessed against this company on or before June 30, 1915, pursuant to the requirements of the Federal Income Tax Act of October 3, 1913."

I regret that Mr. Stanton, whom you represent, will not approve of our action, but, as the law stands, our directors do not feel that there is any other course open to them.

Very truly yours,

(Signed) WILLIAM A. PAINE,
President Baltic Mining Co.

16 On the twelfth day of said February, the following Respondents' Motion to Dismiss Bill was filed:

Respondents' Motion to Dismiss Bill.

(Filed February 12, 1915.)

Now come all the respondents in the above entitled suit and move to dismiss the complainant's bill for the following reasons, viz:—

1. Because the Income Tax Law (Sec. 2 of the Act of Congress of October 3, 1913.) as well as Sub-section G. (*b*) specially relating to mines and to allowances deductible by mines from their gross income by reason of depletion of their ore deposits, are constitutional and valid, under the Fifth and Sixteenth Amendments to the Federal Constitution.

2. Because the complainant has not, in and by his said bill, made or stated such a case as entitles him in a court of equity to any re-

lief against the respondents or any of them, as to the matters contained in said bill or any of such matters.

Wherefore the respondents pray the judgment of this Honorable Court whether they shall be compelled to make any answer to the said bill; and they humbly pray to be hence dismissed, with their reasonable costs in this behalf sustained.

WILLIAM P. EVERTS,
Solicitor and Counsel for Respondents.

I hereby certify that, in my opinion, the foregoing motion to dismiss is well founded in point of law.

WM. P. EVERTS,
Solicitor and Counsel for Respondents.

Thereupon, on the same day, the following Final Decree is entered:

17 *Final Decree.*

February 12, 1915.

This cause came on to be heard upon the motion to dismiss the bill made by the respondents and thereupon it is ordered, adjudged and decreed that the motion to dismiss be allowed and that the complainant's bill be and the same is hereby dismissed, with costs to be paid by the complainant to the respondents.

By the Court:

JOHN E. GILMAN, Jr.,
Deputy Clerk.

From the foregoing Final Decree, the complainant claims an appeal to the Supreme Court of the United States, and gives good and sufficient security that he will prosecute his appeal to effect and answer all costs if he fail to make his plea good, and said appeal is allowed accordingly.

A true record.
Attest: WILLIAM NELSON, *Clerk.*

18 *Complainant's Petition for Appeal.*

(Filed February 12, 1915.)

The above named complainant, conceiving himself aggrieved by the final decree of this court, made and entered on February 12, 1915, in the above entitled cause, does hereby appeal from said decree to the Supreme Court of the United States, for the reasons specified in the assignment of errors which is filed herewith, and prays that this appeal may be allowed, and that a transcript of the record, proceedings and papers upon which said decree was made, duly authenticated, may be sent to the Supreme Court of the United States.

CHARLES A. SNOW,
Solicitor and Counsel for Complainant.

The foregoing claim of appeal is allowed.

FREDERIC DODGE,
United States Circuit Judge.

19 *Assignment of Errors.*

(Filed February 12, 1915.)

And now comes the above appellant (the original complainant) and with his petition for appeal makes and files the following assignment of errors, and says that in the record and proceedings in the above entitled suit there is manifest error, in that the District Court erred in upholding the constitutionality of the Income Tax law (Section 2 of the Act of Congress of October 3, 1913) and of the special Sub-Section [G (*b*)] of said Act, so far as it relates to ascertaining the net income of mines, and in refusing to hold the said Act or the said sub-section of said Act unconstitutional, under the Federal Constitution, for the following reasons set forth in the bill, viz:—

(1) Because said Income Tax law arbitrarily, and without proper reason or classification, discriminates against mining companies, and in favor of all other kinds of corporations and all individuals not owning mines, with respect to the kind and amount of depreciation allowed to be deducted in ascertaining net income, by allowing all other classes of corporations and all such individuals to deduct a fair and reasonable percentage for depreciation and losses of their capital; whereas mines and mining companies are arbitrarily and unreasonably forbidden so to do, and are absolutely restricted to a basis for deduction having no material bearing upon their real losses and amounting only to 5% of their gross income, thereby taxing mining companies in this respect much more severely than all other classes of corporations or individuals not owning mines.
20 That by such arbitrary discrimination mining companies, including the respondent company, and their stockholders are deprived of their property without due process of law, in violation of the Fifth Amendment to the Federal Constitution. (See 12th Paragraph of bill, Section 1.)

(2) Because the special provisions of said Income Tax law contained in said Sub-Section (G. *b*), in so far as they arbitrarily impose on mining companies and mines particularly onerous conditions, with respect to depreciation and depletion of ore supplies, which are not at the same time applied to any other classes of corporations or to any individuals not owning mines, are unconstitutional and void under the Fifth Amendment, in that they deny to mining companies and their stockholders equal protection of the laws and deprive them of their property without due process of law. (See 12th Paragraph of bill, Section 2.)

(3) Because the 16th Amendment authorizes only a tax upon incomes. This tax, as applied to mines, is a tax on capital and property, and not upon incomes, because the actual losses and the fair

depreciation, by way of depletion of ores, are not allowed to be deducted from the gross receipts.

Being a tax upon capital and property, in so far as the actual net income is not attempted to be reached by proper deductions from the gross receipts, the said Income Tax law, as applied to mining companies, is a direct tax on property and therefore is unconstitutional and void, because it is in violation of Clause 4 of Section 9 of Article 1 of the Federal Constitution, providing that no capitation or other direct tax shall be laid by Congress unless in proportion to the census or enumeration in said Constitution directed to be taken; and also because it is in violation of Clause 3 of Section 2 of Article 1 of the Federal Constitution, providing that direct taxes shall be apportioned among the several States according to their respective numbers. (See 12th Paragraph of bill, Section 3.)

21 (4) Because the said Income Tax unlawfully classifies and discriminates between corporations or individuals not owning mines and companies or individuals owning mines, by taxing the net income of the former class and by taxing, in effect, the gross receipts of the latter class, irrespective of their net income, and, accordingly, denies to mining companies equal protection of the laws and deprives them of their property without due process of law, in contravention of the Fifth Amendment. (See 12th Paragraph of bill, Section 4.)

(5) Because the said Income Tax law further discriminates unlawfully against mining companies, in that said companies are limited to a deduction for depreciation based on the actual cost of their mines, under said law as administered under the Income Tax Regulations issued by the Commissioner of Internal Revenue; Whereas all other classes of corporations are allowed to deduct the real depreciation of their property based on its fair value, instead of its actual original cost. (See Paragraph of bill, Section 5.)

(6) Because the said Income Tax law is retroactive, as against mining companies, by covering a period prior to the ratification of the 16th Amendment, and because, further, a new and onerous special excise is imposed on mining companies for such period, namely, for January and February, 1913, by Section 4, Paragraph 8 of said law; Whereas all other classes of corporations were made subject, so far as concerns said period, to the unchanged provisions of the Superseded Federal Corporation excise law of August 5, 1909.

Whereby mining companies were denied equal protection of the laws and deprived of their property without due process of law, in violation of the Fifth Amendment. (See 12th Paragraph of bill, Section 6.)

(7) Because said Income Tax law is grossly unfair and unequal and denies the equal protection of the laws and due process of law guaranteed by the Fifth Amendment, in that it levies double taxation, when applied to holding companies and corporations the stock of which is owned by holding companies, for not only is the operating company taxed for its own income, but also, in effect, upon its dividends paid to the holding company. (See 12th Paragraph of bill, Section 7.)

(8) Because said Income Tax law unlawfully discriminates between individuals and corporations, in that individuals hav-
22 ing incomes in excess of $20,000 are made subject to a surtax thereon of from 1 to 6 per cent additional taxes, whereas corporations having incomes in excess of $20,000 pay nothing beyond the normal tax of 1% on their income, such discrimination being in violation of equal protection of the laws, and due process of law, as guaranteed by the Fifth Amendment. (See 12th Paragraph of bill, Section 7.)

(9) Because the exemptions under said Income Tax law of individual incomes below $4,000 and of incomes of labor organizations are manifestly arbitrary, unfair, discriminatory and unconstitutional, in that they deny the equal protection of the laws and due process of law guaranteed by the Fifth Amendment. (See 12th Paragraph of bill, Section 8.)

JOHN R. STANTON,
(Original Complainant) Appellant.
By his Solicitor and Counsel, CHARLES A. SNOW.

23 *Bond on Appeal.*

(Filed and Approved February 12, 1915.)

Know all men by these presents, That we, John R. Stanton, of the City, County and State of New York, as principal, and Fidelity and Deposit Company of Maryland, a corporation duly established and existing under the laws of the State of Maryland, and having an usual place of business in Boston, Massachusetts, as surety, are held and firmly bound unto the Baltic Mining Company, a corporation duly established and existing under the laws of Michigan and having an office in said Boston, William A. Paine, Frederic Stanwood, Samuel L. Smith, Thomas S. Dee and F. Ward Paine, in the full and just sum of two hundred and fifty (250) dollars, to be paid to the said Baltic Mining Company, and the said William A. Paine, Frederic Stanwood, Samuel L. Smith, Thomas S. Dee and F. Ward Paine, jointly and severally, and its or their respective executors, administrators, successors or assigns: to which payment, well and truly to be made, we bind ourselves, our heirs, executors, administrators and successors, jointly and severally, by these presents. Sealed with our seals and dated this 12th day of February, in the year of our Lord one thousand nine hundred and fifteen.

Whereas, lately at a District Court of the United States for the District of Massachusetts, in a suit in equity depending in said Court between the said John R. Stanton, complainant, and the said Baltic Mining Company, William A. Paine, Frederic Stanwood, Samuel L. Smith, Thomas S. Dee and F. Ward Paine, respondents, the said suit being numbered 609 in Equity, a decree was entered against the said complainant under date of February 12, 1915, dismissing the complainant's bill and the said complainant having obtained an appeal to remove said cause to the Supreme Court of the United States,

to reverse the decree in the aforesaid suit, and a citation directed to the said respondents, citing and admonishing them to be and appear in the said Supreme Court of the United States, in the city of Washington D. C., within thirty days from the date of said citation.

Now, the condition of the above obligation is such, That if the said complainant shall prosecute his appeal to effect, and answer all costs if he fail to make his appeal good, then the above obligation
24 to be void; else to remain in full force and virtue.

JOHN R. STANTON, [SEAL.]
Per CHARLES A. SNOW,
Att'y of Record for John R. Stanton, Complainant.
FIDELITY AND DEPOSIT COMPANY OF MARYLAND, [SEAL.]
By WALLACE EGERTON,
Resident Vice-President.

Sealed and delivered in presence of

—— ——.

Attest:
EDMUND MOORE,
Resident Assistant Secretary.

This bond is satisfactory to the respondents and is approved by their counsel.

WM. P. EVERTS.

Approved:
FREDERIC DODGE,
United States Circuit Judge.

25 *Citation on Appeal.*

UNITED STATES OF AMERICA, *ss:*

The President of the United States to the Baltic Mining Company, a Corporation Duly Established and Existing Under the Laws of Michigan and having an Office in Boston in the State and District of Massachusetts; William A. Paine, of said Boston, President and Director of said Company; Frederic Stanwood, of Brookline, in said State, Treasurer and Director of said Company; Samuel L. Smith, of Detroit, in the State of Michigan; Thomas S. Dee, of said Boston, and F. Ward Paine, of Houghton, in the State of Michigan, Directors of said Company, Greeting:

You are hereby cited and admonished to be and appear in the Supreme Court of the United States in the city of Washington, D. C. thirty days from this date, pursuant to an Appeal duly obtained from a decree of the District Court of the United States for the District of Massachusetts wherein John R. Stanton of the City, County and State of New York, the original complainant, is appellant and you, the original respondents, are appellees, to show cause, if any

there be, why the said decree entered against the said appellan should not be corrected, and why speedy justice should not be don to the parties in that behalf.

Witness, the Honorable Frederic Dodge, Circuit Judge, duly as signed to hold the District Court of the United States for the Distri of Massachusettts this twelfth day of February, in the year of ou Lord one thousand nine hundred and fifteen.

FREDERIC DODGE,
U. S. Circuit Judge.

26 *Acknowledgment of Service on Citation on Appeal.*

Due service of the within citation is hereby acknowledged
WM. P. EVERTS,
Solicitor and Counsel for Appellee.

27 *Clerk's Certificate.*

UNITED STATES OF AMERICA,
District of Massachusetts, ss:

I, William Nelson, Clerk of the District Court of the United States within and for the District of Massachusetts, certify that the fore going is a true copy of the record in the cause in equity entitled, No 609, John R. Stanton, Complainant, v. Baltic Mining Company e al., Defendants, in said District Court determined, the Complainant' Petition for Appeal, the Assignment of Errors, the Bond on Appea and also the original Citation issued upon the appeal of the com plainant in said cause, with the Acknowledgement of Service thereon

In testimony whereof, I hereunto set my hand and affix the sea of said District Court, at Boston, in said District, this seventeent day of February, A. D. 1915.

[Seal of the District Court of Massachusetts.]

WILLIAM NELSON, *Clerk.*

Endorsed on cover: File No. 24,572. Masachusetts D. C. U. S Term No. 828. John R. Stanton, appellant, vs. Baltic Minin Company et al. Filed February 24th, 1915. File No. 24,572.

10

Supreme Court of the United States

OCTOBER TERM, 1914.
No. 828. 359

JOHN R. STANTON, *Appellant*,

v.

BALTIC MINING COMPANY ET AL.

MOTION TO ADVANCE.

Now comes John R. Stanton, the appellant in the above-entitled cause, and respectfully moves that the said cause be advanced for hearing and be set down for hearing at the same time already set for other cases involving the Federal Income Tax, namely, on October 12th next, or such other time as the Court may deem best.

JOHN R. STANTON,
Appellant.

By his Solicitor,
CHARLES A. SNOW.

I, William P. Everts, Solicitor for the defendants in the above-entitled cause, hereby consent that the said cause may be advanced and that the above motion may be granted.

WILLIAM P. EVERTS,
Solicitor for Defendants.

//

Supreme Court of the United States.

OCTOBER TERM, 1915.

No. 359.

JOHN R. STANTON,
Appellant

v.

BALTIC MINING COMPANY ET AL.

Appeal from the District Court of the United States for the District of Massachusetts.

BRIEF FOR APPELLANT.

CHARLES A. SNOW,
Counsel for Appellant.

Supreme Court of the United States.

OCTOBER TERM, 1915.

No. 359.

JOHN R. STANTON, *Appellant*,

v.

BALTIC MINING COMPANY ET AL.

APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF MASSACHUSETTS.

BRIEF FOR APPELLANT.

CHARLES A. SNOW,
Counsel for Appellant.

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Supreme Court of the United States.

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No. 359.

JOHN R. STANTON, *Appellant,*

v.

BALTIC MINING COMPANY ET AL.

APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF MASSACHUSETTS.

BRIEF FOR APPELLANT.

STATEMENT OF CASE.

The question here is whether the Income Tax law is unconstitutional as applied to mining companies,—

(1) Because it permits or requires direct taxation of their capital assets, without apportionment, according to population, which is not authorized by the Sixteenth Amendment;

(2) Because it arbitrarily singles out mining companies, and applies special rules of valuation and taxation to them, which no other class of corporations is subjected to, and thus unlawfully discriminates against them, in violation of

"due process of law," as guaranteed by the Fifth Amendment;

(3) Because it arbitrarily discriminates against holding companies and operating companies owned by them, by subjecting them to double or additional taxation.

The 5% deduction clause [Sub-Section G (*b*)], applicable only to "mines," is here specially involved.

This special provision is separable from the rest of the Income Tax law. But, if not, the whole Income Tax law, as applied to mines, is unconstitutional, upon the grounds above stated.

This clause allows mines to deduct from their *gross income* or *gross receipts*, besides operating expenses, a maximum of 5% of the *gross value* of their annual "output," in order to represent their fair losses, by way of depletion of ore supplies, in the ascertainment of their taxable "net income."

Terms of Income Tax Law, as to Corporations.

The Income Tax law, with respect to corporations, as contained in Sub-Section G (*a*), provides —

> "that the normal tax hereinbefore imposed upon individuals likewise shall be levied, assessed, and paid annually upon the *entire net income* arising or accruing from all sources during the preceding calendar year to every corporation, joint-stock company or association, and every insurance company organized in the United States, no matter how created or organized, not including partnerships." (Act of October 3, 1913, Section 2.)

Various exemptions from the tax are provided for, including labor, agricultural or horticultural organizations, and certain kinds of mutual savings banks, fraternal beneficiary societies, building and loan associations, cemetery companies, and corporations or associations organized

exclusively for religious, charitable, scientific or educational purposes, business leagues, chambers of commerce, boards of trade, and civic leagues or organizations not organized for profit, but operated exclusively for the promotion of social welfare.

Income derived from public utilities or from the exercise of essential governmental functions of states or their political subdivisions, is also exempted.

Terms of Special Five Per Cent Deduction Clause, Applicable Only to Mines.

Sub-Section G (b) of the Act provides —

> " Such *net income* shall be ascertained by deducting from the *gross amount of the income* of such corporation, joint-stock company or association, or insurance company, received within the year from all sources, (first) all the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties, including rentals or other payments required to be made as a condition to the continued use or possession of property; (second) *all losses* actually sustained within the year and not compensated by insurance or otherwise, including a *reasonable allowance for depreciation* by use, wear and tear of property, if any; and in the case of *mines* a *reasonable allowance* for *depletion* of ores and all other natural deposits, *not to exceed 5 per centum of the gross value at the mine of the output* for the year for which the computation is made."

Upon its face, the Act professes to exact a direct tax strictly limited to a tax on " net income "; but, in effect, it taxes *capital* or principal, as will be shown.

Sixteenth Amendment Authorizes Direct Taxes on Income, Not on Principal.

The Sixteenth Amendment only authorizes direct taxes upon *incomes:*

> " ARTICLE XVI. — The Congress shall have power to lay and collect taxes on *incomes*, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration." (See Ratification, Mass. Acts 1913, p. 1187.)

Taxes upon incomes, derived from real or personal property, are direct taxes and, as such, were unconstitutional until the ratification of the Sixteenth Amendment, unless apportioned according to population.

The purpose of this amendment was to abolish the constitutional bars against *income* taxes, as one form of direct taxation, which were established by the *Pollock* decision (*Pollock* v. *Farmers' Loan & Trust Co.*, 157 U. S. 429.)

Its effect is to authorize *income* taxes, although one form of direct taxation.

No intention is manifested to let down the bars as to other forms of direct taxation.

Other Constitutional Bars Still in Force, Prohibiting Direct Taxes on Property, Other than Incomes, Unless Apportioned.

Except as to direct taxes upon *incomes*, it requires no argument to show that the constitutional prohibitions against direct taxes upon property, real or personal, unless apportioned, are still in force, in accordance with the rule laid down in the *Pollock* case.

These prohibitions are as follows:

> " Representations and direct taxes shall be apportioned among the several states which may be included within

this Union, according to their respective numbers." (U. S. Constitution, Article 1, Section 2, clause 3.)

"No capitation, or other direct tax, shall be laid, unless in proportion to the census or enumeration hereinbefore directed to be taken." (U. S. Constitution, Article 1, Section 9, clause 4.)

Real Effect of Five Per Cent Clause is to Tax Principal, Not Merely Income.

Whatever it may purport to do, if the real effect of the 5% limit, when its substance is reached, apart from its form, is to allow mines to deduct from their gross receipts only a *portion*, large or small, but *not the whole*, of their annual losses, through depletion of capital assets, for the purpose of ascertaining their taxable "net income," then it necessarily follows that the remaining portion of such losses, not deducted, is taxable as if it were income, when, in fact, capital.

Natural or Necessary Effect of Five Per Cent Clause on Mining Companies, in General, Without Regard to Allegations of This Bill.

Before stating the precise allegations in this bill as to the actual effect of the 5% clause, the natural or necessary effect of such a limitation upon mining companies in general, and particularly as compared with income taxes levied on other classes of corporations, may be made sufficiently obvious without evidence.

Assuming that a mining company and a manufacturing corporation each have capital assets to the value of $30,000,000, the former in the shape of unmined ore deposits, and the latter in the form of machinery and plant, and that the gross value of the annual product of each amounts to $3,000,000.

Under ordinary conditions, by the usual practice of cor-

porations as well as the Treasury Department, a manufacturing plant may fairly be considered as deteriorating at the rate of 5% per annum.

Under the Income Tax law, a manufacturing company is entitled to deduct from its gross income *all* losses, including a fair and reasonable depreciation, which, at the rate of 5%, on a $30,000,000 manufacturing plant, amounts to $1,500,000.

A mining company, on the contrary, is not allowed to deduct *all* losses, depreciation or depletion, but only a portion.

It is limited by the Act to deducting, as annual losses arising from depletion of its ore deposits, a maximum limit of 5% of the "gross value at the mine of the *output*," regardless of what may be its *actual* losses. Five per cent. depreciation on its $3,000,000 output amounts yearly to $150,000.

Five per cent allowance, based on gross receipts, ordinarily results in the receipt by mines of only one tenth, or other small percentage, of allowance made to manufacturing companies under similar conditions, the allowance there being based on total value of plant or principal.

In the case assumed, by reason of this purely arbitrary and artificial limitation, applicable only to mines, the manufacturing company is allowed ten times as much depreciation as the mining company.

Although it might fairly be anticipated, because of the peculiarly wasting character of a mining investment, that it would deteriorate at a faster rate than manufacturing plants, the law steps in and artificially affects the situation so that the mining company becomes entitled to deduct only one tenth as much, for depreciation, as the manufacturing company. Gross discrimination will appear in almost any case which can fairly be assumed, when a mining company is compared with other classes of corporations.

The figures used in the illustration are not at all fanciful, but, as will appear from the Record, fairly represent, if they do not understate, the extent of the arbitrary discrimination exercised against mining companies, and in favor of *all* other kinds of corporations, partnerships and individuals which do not happen to have their capital invested in mines.

The discrimination and favoritism shown under this Act arise solely because of the operation and effect of the 5% limit. The discrimination inevitably results in extensive pecuniary loss to mining companies.

A manufacturing company is allowed to deduct, as depreciation, 5% of the value of its total *principal* or capital invested in plant.

A mining company is arbitrarily limited to deducting for losses, by depletion of its capital assets, a maximum of 5% of its annual *gross receipts* or output.

The percentage is the same in either case.

Principal or capital assets ordinarily exceed the amount of the annual receipts, many times over.

As in the case at bar, they may be ten times that amount.

Thus 5% deduction on plant is equivalent to ten times the amount of a 5% deduction based on annual gross receipts.

Mining Companies are Taxable Partly on Principal, in Addition to Income. — All Other Corporations Are Taxed Merely on Net Income.

Arbitrary discrimination also becomes apparent, when it is realized that this 5% clause necessarily results in the direct taxation, in part, of the *capital* assets of mining companies, *besides* taxing their "net income," while all other corporations are taxed only on "net income."

Of course, arbitrary discrimination need not be shown, if this tax constitutes *in any degree*, or to any extent, a

direct tax on capital assets, instead of being confined to a tax on "net income," as authorized by the Sixteenth Amendment.

Manufacturing and *all* other classes of companies, except mining corporations, are allowed to deduct sufficient depreciation to restore wastage and losses of capital.

Their *capital* cannot, in any form, or to the slightest degree, be touched by the tax, but only their "net income."

Mining companies, however, are allowed to deduct, for losses through depletion, only a small fixed maximum percentage, amounting, as shown by the Record, only to a portion, and that usually a trifling part, of their *actual* wastage and losses of capital.

The remaining losses, not deducted, are not allowed to be restored to principal, but, although capital, are treated, for purposes of taxation, as if they were income.

The Act, upon its Face, Indicates the Intention to Tax Principal or Capital of Mines, to Some Extent.

The Act, upon its face, shows clearly the intent to tax the capital assets of mines, to some extent, at least. Why *any* maximum limit? If the facts, in any particular case, show depletion of capital assets in excess of the maximum limit, why should not the actual loss be allowed, to its fullest extent, unless the intent of the Act was to tax the capital assets of mining companies, and thus discriminate against them?

The Act plainly admits that depletion of ore deposits constitutes, to some extent, a wastage or loss of capital, which must be restored to the principal before there can be any *net income*, but confessedly does not allow the whole depletion to be shown and deducted in *all* cases (or, indeed, in *any* case, unless a very exceptional one).

The Act provides, in terms, that, for purpose of ascertaining "net income," there is deductible, in case of mines,

a "*reasonable* allowance for depletion of ores and all other natural deposits."

The proper principle is thus recognized, that such depletion represents a loss of capital, which must be restored and rendered intact before any *income*, whether gross or net, can, in any proper sense, be realized.

If the Act had stopped at that point, it would be unobjectionable, in point of justice and constitutionality.

But the Act then proceeds arbitrarily to limit the right to deduct for depletion, by providing that it shall not be allowed to its *full* actual extent.

Where a "reasonable allowance," for depletion of capital, exceeds 5% of the gross receipts, the excess cannot be deducted, but is taxable, although capital, and notwithstanding the fact that it represents a fair and "reasonable allowance" for such depletion.

Theory of Bill Totally Different from Stratton's Independence Case (231 U. S. 399).

The bill throughout is based on facts totally different from those appearing in *Stratton's Independence, Limited,* v. *Howbert* (231 U. S. 399), and avoids the extreme and unjustifiable claim adjudicated against in that case.

This bill specifically admits that the annual product extracted from the ore deposits in a mine is not wholly and exclusively capital or principal, as claimed in that case, but, on the contrary, represents capital, in part, and income, in part.

That case, as presented, involved the wholly untenable theory, that the annual product of a mine depletes its capital assets to precisely that extent, and *includes no income* whatsoever, and that the exact value of its annual product, representing capital exclusively, must first be deducted from "gross income" before the "net income" can be arrived at. That theory involved the practical result

that mining companies can have no net income, and consequently should pay no taxes under the Income Tax act or the Federal Corporation Excise law.

This bill, however, expressly admits that a portion of the annual receipts from sale of copper represents *net income*, although the larger part represents depletion of capital assets, consisting originally of unmined ore deposits, at their value in place in the ground.

Figures in This Bill, Showing What Portion of This Company's Product Represents Principal, and What is Income, Resulting from an Actual Valuation Made, Pursuant to the Government's Direction, before the Income Tax Law was Enacted.

At the several dates when the Income Tax and the earlier Federal Corporation Excise were enacted, this company had unmined ore deposits, of an estimated life of forty years, removable at the estimated rate of one fortieth, or 20,000,000 pounds, per annum. These deposits were valued, as of January 1, 1909, and prior to the passage of these laws, in accordance with the instructions of the Federal Government, at their fair cash market value as unmined ore, at its value in place in the ground, if sold in bulk at that time, without regard to the interest receivable on the investment or to the profits otherwise derivable through the annual disposition of the product, at the changing prices of copper, during a period of forty years (Rec. 2).

In other words, the valuation covered, among other things, the question as to the present cash value of a fund or invested principal, payable in the future, in equal instalments, during a period of forty years.

The fair market price of copper during this period was estimated to be 15 cents per pound (Rec. 2), a price easily demonstrable, but here admitted by demurrer, as well as confirmed by the present price, which, since the date of

the bill, has risen to 20 cents, as a matter of common knowledge.

The fair cost of extracting copper was estimated at eight cents per pound (Rec. 3).

The net receipts without any depreciation charge, accordingly, amounted to seven cents per pound, or, on a yearly product of 20,000,000 pounds, to $1,400,000 per annum, or to $56,000,000 during the entire forty-year period (Rec. 3).

The immediate fair cash value of an ultimate fund of $56,000,000, receivable from ore deposits, in equal annual instalments, during a term of forty years, considering also all other elements of value, was estimated to amount to one half the total sum receivable, or to $28,000,000, or three and one-half cents per pound (Rec. 3).

One half of this company's net receipts, after payment of operating expenses, represents principal, and one half net income.

The valuation of the total unmined ore deposits, in place, were thus valued at a net unit value of three and one-half cents per pound, or at a gross unit value, including cost of extraction, of eleven and one-half cents per pound, as against the average selling price of fifteen cents per pound during the preceding thirty years, and, as can be demonstrated, the fair average price of fifteen cents during the next forty years (Rec. 2, 3).

The result of this valuation is that the actual present cash valuation of the unmined ore deposits, in place, was fixed at a definite, unchangeable sum, as of the date of January 1, 1909.

Whatever amount of its annual product may represent the depletion of its capital, consisting of its unmined ore deposits, in place, in the ground, at their fair market value as such, is deductible from the "gross receipts" before any *income*, properly so called, whether gross or net, can, in any way, result.

The original capital assets are thus restored and made intact.

The balance of its " gross receipts," after such allowance, represents its *gross income.*

Deducting operating expenses, the *net income* remains, for which alone the corporation is properly taxable.

Under the company's valuation, it is taxable, as for "net income," on whatever it receives above eleven and one-half cents per pound, fifteen cents being the fair average selling price of copper.

The obvious result is that the Government, from the start, receives taxes, which are based on whatever price copper, in the future, may sell at, in excess of eleven and one-half cents per pound, a very low figure, unless all past experience, and expert judgment as to the future, shall prove to be unreliable, in fixing the fair average price of copper at fifteen cents per pound.

But, whatever may be the future results, that portion of the selling price of the extracted mineral which exceeds eleven and one-half cents per pound represents the company's *net income*, and the three and one-half cents under that figure, constitutes depletion of *capital* assets.

The Government also gets the advantage of all profits made by the company outside of the fixed unit value of its principal or capital represented by unmined ore deposits.

So, also, whatever reduction may be made in the cost of extraction, below eight cents per pound, whether through skill in management, improvements, added richness of ore, or otherwise, represents additional taxable *net income.*

Further, whatever new deposits may be discovered, after the date of valuation, represent sources of additional profit and taxable net income, for the company is strictly limited to the restoration of its original capital assets, as valued on January 1, 1909. If, as sometimes occurs, the ore in place was underestimated, the Government also gets the benefit of that fact.

Moreover, the Government necessarily gets the benefit of all interest accruing on the yearly instalments of original capital value, and included in the difference between the immediate present gross unit value of eleven and one-half cents, as estimated, and the future value of fifteen cents per pound, as will actually be derived from the yearly instalments, during the forty-year term.

Thus, the Government gets the benefit of all income or profit, whether derived from manufacturing or marketing processes, from changing market prices of the product, interest on the present value, new discoveries, or otherwise, leaving to the owner only the right to keep his original capital intact. When that has been accomplished, by proper deduction for losses and depletion, the question of taxable " net income " arises, for the first time.

The exact figures are not important.—The material inquiry is whether ANY portion of this company's CAPITAL assets is taxable under the five per cent clause. If so, such taxation is unconstitutional.

The exact figures as to what are the profits or " net income " of this company, or as to what portion of the annual sales represents depletion of capital, are of no material consequence here, although admitted by demurrer.

The only material inquiry is whether *any part* of its capital assets is taxable, under the 5% clause.

It is shown by the allegations of the bill that principal is here taxed to a very large extent. But whether the amount be large or small, the mere fact that, under this 5% clause, the *capital* assets of mines are ordinarily or necessarily taxable *to some extent*, at least, renders this Act obnoxious to the constitutional prohibitions against direct taxation, without apportionment, of *any* property, other than incomes.

That portion of this company's sales of copper which represents its net profits is properly taxable under an Income Tax making due provision for the ascertainment

of its actual *income*, by distinguishing it from *capital* or principal.

That portion which represents merely depletion or loss of capital is principal, which, not being *income*, cannot constitutionally be taxed.

An Act which establishes a rule of valuation, whereby principal is necessarily taxed, *to some extent*, and furnishes no means for distinguishing or separating income from capital, or, indeed, forbids such separation, is wholly void, because void in part, even though a portion of the amount taxed consists of "net income," and might properly be taxable, as such, if the special 5% clause had been omitted, or if other provision had been made, allowing a proper deduction from the gross receipts, to represent *all* depreciation, losses and depletion of capital assets.

Additional Facts Admitted by Demurrer.

The demurrer admits, for the purposes of the case, the following additional facts: —

This company owns and operates a copper mine in Michigan (Rec. 2).

A Case of Double Taxation Presented.

Over 99% of this company's shares are owned by a holding company, the Copper Range Consolidated Company, which is also taxable, "for income through large dividends received from the respondent company" (Rec. 2).

This presents a case of double taxation, for the operating company's income is, in effect, twice taxed, (1) in the shape of its own profits, and (2) in the form of dividends declared out of its earnings and paid over to the holding company.

Official Valuation of Company's Ore Deposits, in Place, Made Pursuant to Government's Direction.

On March 30, 1911, long before the passage of the Income Tax law, this company made and filed an official estimate as to the total amount of its ore deposits.

This included only known deposits, but no future discoveries (Rec. 2).

The value of pure copper, during the forty years' life of the mine, is reckoned at fifteen cents per pound (Rec. 2).

This was the approximate value of copper at the date of the bill. The "average price of copper during the past thirty years has been over fifteen cents per pound" (Rec. 3).

This mine was valued, "at its fair value," at $28,000,000, and is now of such value, less such amount as has been extracted since the date of valuation (Rec. 3).

The mine then contained unmined ore deposits of 800,000,000 pounds, or sufficient for a yearly output of 20,000,000 pounds during the forty-year term (Rec. 3).

This output would yield gross receipts of $3,000,000 per annum.

The average cost of extraction is eight cents per pound, leaving an apparent profit of seven cents per pound, at the average market price of copper.

The "net yearly value" of its 20,000,000 pound production, above the cost of extraction, is $1,400,000 (Rec. 3).

The total unmined ore deposits, amounting to 800,000,000 pounds, "represent and constitute the capital or principal of the investment" made by the company, outside of machinery and equipment (Rec. 3).

"The extraction and depletion of said deposits represent a constant diminution *pro tanto* of the capital or investment" (*ibid.*).

"The net receipts, above expenses, realized from the sale of the company's annual product, represent and constitute, to *the extent of one half or more of the entire net re-*

ceipts, a realization into money of a constantly diminishing capital or investment consisting originally of the unmined deposits of copper ore" (*ibid.*).

Such receipts also cover the annual depreciation or replacement, at the rate of 5%, of the necessary machinery and equipment required for extraction of the mineral, and valued at $2,000,000 (*ibid.*).

Out of the entire yearly net receipts of $1,400,000, about seven per cent, or $100,000, represents the yearly depreciation of machinery and equipment, and "approximately $750,000, or fifty-three per cent thereof, represents nothing but the depletion of capital caused by removal of ore deposits, and does not represent or include any amount whatsoever of income" derived by the company (Rec. 4).

[By a slight error, the exact figures having no bearing on the constitutional claims, instead of the above $750,000, the bill should have stated the figure at $700,000, or the unmined value of the yearly product of 20,000,000 pounds, at the unit value of 3½ cents per pound, as elsewhere stated in the bill.]

"Only the remainder, or approximately forty per cent of the respondent company's net receipts over and above the total deductions, as aforesaid, of $850,000 per annum, represents the company's net income derived from all sources, whether from manufacturing, mining, selling or otherwise" (*ibid.*).

Company Taxed for Twice Its Actual Income.

Its real taxable income is $550,000 (Rec. 5), or $600,000, with the above correction.

Under the 5% clause, it is held taxable, in an average year, for $1,150,000, or nearly double its real income, when properly and fairly ascertained (Rec. 5).

Company Arbitrarily Limited to Deducting Only One Fifth of Actual Losses by Depletion, While All Other Corporations are Allowed to Deduct the Whole.

Although $700,000 per annum represents nothing but depletion and losses of capital assets, the company is arbitrarily limited, under the 5% clause, to deducting, for such depletion, only $150,000 per annum, or 5% of its gross annual *output*, whereas $700,000 should properly be allowed to represent actual losses, or nearly five times the amount allowed.

All "other classes of corporations, and all individuals not owning mines, are allowed to deduct their *full* actual losses by depreciation or depletion of capital assets" (Rec. 4).

Tax on the Difference between Actual Losses and Amount Allowed Represents Taxation on Capital, Not on Income.

"The tax on the difference between the arbitrary allowance of $150,000 and the real losses of $750,000 [$700,000], through depletion of capital assets, is a tax on capital, and not upon income" (Rec. 4).

Five Per Cent Clause Allows Deduction of Only One Eight-hundredth of Gross Value of Deposits, or One One Hundred Eighty-Sixth of Present Net Market Value of Total Unmined Deposits, in Place.

In view of its forty-year life, the ore deposits will be exhausted at the rate of one fortieth per annum.

Five per cent of the annual "output," under the 5% clause, allows an annual deduction based on one-twentieth of one-fortieth, or one eight-hundredth of the total ore deposits, at their gross value, when converted into cash by instalments, during the forty-year term.

This allowance also represents only one one hundred eighty-sixth of the present market value of the entire body of unmined ore deposits, in place, if disposed of *en bloc* at the time of the valuation.

All Other Classes of Corporations Allowed to Deduct Five Per Cent of Principal, rather than of Annual Gross Receipts.

By common knowledge, all other classes of corporations and all individuals not owning mines, are ordinarily allowed to deduct, for depreciation of machinery or plant, approximately 5% of the *principal*, instead of being arbitrarily limited, like mines, to 5% of their annual *gross receipts* or " output," to represent depletion and losses.

Comparison with Manufacturing Companies.

A mining company may annually deduct, for depletion of capital assets, a sum equivalent to one one hundred eighty-sixth of the market value of its total capital assets.

A manufacturing company may, however, deduct a " reasonable allowance " for depreciation of machinery and plant, whatever it may to amount to, and without limitation, but ordinarily equivalent to one twentieth of its capital investment, or nearly ten times the maximum allowed to mines (Rec. 6).

And this represents only the minimum point of the discrimination against mines, for the figures take into consideration only the ordinary depreciation of a manufacturing plant, arising from " use, wear and tear of property." under the terms of the Act. They also are allowed for " exhaustion " and " obsolescence," under Treasury Regulations (Art. 129).

All Other Corporations may Deduct Their Full Losses Arising from Any Causes.

Moreover, all other classes of corporations are allowed to deduct their *full* actual losses, whether occasioned by depletion of capital assets or otherwise, and are not arbitrarily limited to a maximum of 5% of the *gross receipts* or " output."

A mining company, apparently, could take no account of total or partial loss of mineral assets, even if its mine should be wrecked by earthquake, explosion or fire, except subject to this trifling allowance.

All other corporations may deduct " all losses actually sustained within the year and not compensated by insurance or otherwise " [Sub-Section G (*b*)].

Further Discrimination against Mines, under Treasury Regulations.

In practice, the discrimination exercised against mines becomes still more unfair, under Treasury Regulations (Circular of January 5, 1914 — Internal Revenue Regulations No. 33).

Losses of other companies arising from *sale* of *capital assets*, whether acquired before or after passage of the law, are allowed to be deducted from gross income (Arts. 109, 128).

So also, in case of changes in book value of capital assets, resulting from reappraisal of property (Art. 111); the annual adjustment of book values of securities, real estate and like assets (Art. 111); depreciation in book value of capital assets (Art. 134); amortization of bonds (Art. 135); exhaustion of capital assets represented by patents (Art. 137); obsolescence of patents (Art. 138); and the exhaustion or depletion of tracts of timber land (Art. 139).

Further, the " depreciation of coal, iron, oil, gas, and all other natural deposits must be based upon the actual

cost of the properties containing such deposits. In no case shall the annual deduction on this account exceed 5% of the gross value at the mine (well, etc.) of the output for the year for which the computation is made" (Art. 141).

This regulation fails to allow a reasonable depreciation on the *value* of the mine, as it existed at the time of valuation. This company originally paid about $1,000,000 for its ore deposits, which, at the date of passage of the Act, were fairly worth $28,000,000 (Rec. 5).

If no depreciation is allowed, except when based upon one twenty-eighth of the real market value of the capital assets, it appears obvious that no attempt is made to reach the actual "net income," and it becomes a clear case of a direct tax on principal.

Double Taxation against Operating Companies Owned by Holding Companies.

The Bill also alleges that the Act arbitrarily discriminates against those companies which are owned by holding companies, in that their earnings are, in effect, subjected to double taxation; whereas other similar corporations, even mining companies, the stock of which is not owned by a holding company, and all individuals, are exempted from double taxation.

Thus, individuals and partnerships, in computing their taxable "net income," are allowed to deduct: "Seventh, the amount received as dividends upon the stock or from the net earnings of any corporation, joint stock company, association or insurance company which is taxable upon its net income as hereinafter provided" (Sub-Section B, clause 7, of Section 2, Act of October 3, 1913).

No such deduction is allowed to holding companies for dividends received by them, under this Act, whereas it was expressly allowed under the Federal Corporation Excise of August 5, 1909. The result is that the earnings

of this company are, in effect, subjected to double taxation, (1) in the form of its own profits, and (2) in the shape of its dividends paid out of earnings to the owner of ninety-nine per cent of its capital stock. Accordingly, the operating company, as well as the holding company, are arbitrarily discriminated against, solely because of the fact that the stock happens to have been purchased by a holding company, rather than a partnership or individuals. The balance of its stock, owned by individuals or partnerships, is relieved from double taxation. Thus, different holders of the same stock are not treated alike. Other classes of corporations and all partnerships and individuals are not subjected to double taxation, under the Act.

SPECIFICATION OF ERRORS RELIED ON.

Constitutional Objections to Income Tax Law, as Applied to Mines.

The constitutional objections to the Income Tax law raised by the appellant are —

(1) The Income Tax, as applied to mining companies, under the 5% clause, prohibits them from deducting the *whole* of their losses, arising from depletion of capital assets, and thus taxes the remainder not deducted, as if it were " net income," when in fact it constitutes a loss of capital assets.

A tax upon the portion of such losses not allowed for is, accordingly, a direct tax upon *capital* and *property*, and not a tax on " incomes," within the meaning of the Sixteenth Amendment.

Being a direct tax on property, without apportionment according to population, the tax violates the constitutional prohibitions against such direct taxes, as set forth in Section 2, clause 3, of Article 1, and Section 9, clause 4, of Article 1 of the Federal Constitution.

The 5% clause as to mines, being separable from the other provisions of the law, is unconstitutional and void.

If, on the other hand, this clause should not be regarded as separable, the entire Income Tax law is unconstitutional and void, as applied to mining companies. (See 3d Assignment of Errors, Rec. 14, 15.)

(2) The Income Tax, as applied to mining companies, under the 5% clause, arbitrarily, and without reasonable basis for distinction, discriminates against mining companies, by allowing *all* other classes of corporations to deduct their *full* losses by way of depletion, and by allowing mining

companies to deduct only a *portion* of their actual losses. Other corporations are granted a " reasonable allowance " for such losses. Mining companies are arbitrarily limited to 5% of their annual *gross receipts*, which represents an *unreasonable* allowance, wholly inadequate to restore *actual* losses of capital, thereby subjecting mining companies to unequal and arbitrary classification, failing to accord to them the " equal protection of the laws," and depriving them of their property without " due process of law," in violation of the Fifth Amendment. (See 1st, 2d and 4th Assignment of Errors, Rec. 14, 15.)

(3) The Income Tax law is unconstitutional, because it violates the " due process " clause upon various general grounds, not peculiar to mines, and particularly because holding companies are taxed on their full net income, derived from dividends, while the operating companies owned by them are also liable to taxation on their net earnings. Thereby, in effect, the earnings of the operating company are doubly taxed, thereby discriminating arbitrarily and unlawfully against it and in favor of all other corporations and all individuals. (See 7th Assignment of Errors, Rec. 15.)

BRIEF OF ARGUMENT.

I.

The Income Tax Law, as applied to mining companies, directly taxes a portion of their principal or capital, without apportionment according to population, and, therefore, is unconstitutional. — Direct Taxes on principal or capital, not being taxes on income, are not authorized by the Sixteenth Amendment.

The Sixteenth Amendment authorizes direct taxes upon "*incomes,*" but not upon capital or property. Income taxes may now be imposed without regard to apportionment among the States, according to their population.

All forms of direct taxation, other than taxes on "incomes," clearly remain subject to the same constitutional limits as formerly.

Whether a tax on "gross receipts" or on "gross income," without any allowance for losses or depreciation, would be authorized by the Sixteenth Amendment, need not here be considered, for the Income Tax law professes merely to tax the "entire *net income* arising or accruing from all sources." (Sub-Section A, Sub-Division 1, of Section 2 of Act of October 3, 1913.)

Subdivision 2 refers to the 1% rate as the "normal *income* tax."

The same expression is used as to the Income Tax on corporations, the Act providing that the "normal tax" imposed upon individuals shall likewise be levied upon the "entire *net income*" of corporations.

The Act nowhere uses the phrase "gross receipts," but refers to "gross income" in these terms:

"Such *net income* shall be ascertained by deducting from the *gross amount of the income* of such corporation," etc.

It might be urged, as a thoroughly sound proposition, that even "gross income" could not, in any proper sense, include money received from the sale of capital assets like ore deposits; that, at most, the profit or gain from the sale of mined ore, at a price in excess of its value as unmined ore, in place in the ground, could be regarded as *income*, in any proper sense; and that losses or depletion in capital assets must first be replaced and restored before any *gross income* can possibly arise.

But the terms of the Act render unnecessary any consideration of the problem suggested.

Under the Act, *gross income* must first be ascertained, and then deductions therefrom must be made, as provided, in order to ascertain the "net income" of the corporation. These deductions specifically include expenses, and, to a certain extent, losses, depreciation and depletion.

The proper meaning of *gross income* was fully explained by the Government in the rulings of the Commissioner upon precisely the same phrase (viz., "gross amount of the income") as it appeared in the Federal Corporation Excise of August 5, 1909, as applied to mines:

"82. — A further deduction will also be allowed, *through not including the same at all in the item of gross income* (item 3, Form 637), for the unearned increment represented in such properties as at January 1, 1909, which will be determined, in general, as follows." (Here follow elaborate requirements as to determining the fair market value, at that date, of the total ore deposits, in place, and the unit value of the same per pound, etc., which were here followed, as stated in the bill.)

"84. — The unit value, as of January 1, 1909, ascertained as above outlined, would indicate the value to be attached at that date to the capital assets disposed of during any calendar year succeeding, and should be

used in determining the unearned increment at January 1, 1909, *which may be excluded entirely from the item of gross income*, as before explained, in following manner." (Synopsis of Decisions of Commissioner of Internal Revenue, issued February 14, 1911, T. D. No. 1675.)

This official statement of the Government's position, under the preceding Act, is thoroughly sound, with respect to what should constitute " gross income," under any conditions.

If so, the 5% clause allowing deduction for depletion of capital assets, was wholly unnecessary, for such deduction was necessary before the amount of " gross income " could, in any way, be ascertained.

But it is here unnecessary to determine the proper definition of " gross income," so far as sales of capital assets are concerned, because the Act professes only to tax " net income."

The Sixteenth Amendment only authorizes direct taxes upon " incomes," obviously meaning *net incomes.*

The 5% clause expressly admits that a " reasonable allowance for depletion of ores " should properly be made *to some extent,* before " net income " can possibly be ascertained, the only reason for such a provision being that principal ought to be restored and rendered intact, to the extent of the allowance.

The clause, however, arbitrarily limits such allowance to 5% of the " gross value " of the annual " output," which is practically equivalent to *gross receipts.*

If this limited allowance, upon the facts in the Record, ordinarily or necessarily has the effect of deducting an amount wholly inadequate to restore the depleted capital assets, the Income Tax, to the extent of the insufficiency, is a direct tax upon principal, and not upon *income,* and is unconstitutional, because not apportioned according to population.

The question here is, whether a tax on gross receipts

from sales of copper, less operating expenses, and deducting also 5% of the gross receipts, to represent depletion, is a tax upon *net income,* wholly and exclusively. For, if it taxes principal or capital *at all,* the tax is unconstitutional and void *in toto,* as applied to mines.

"Gross Receipts" Differ from "Gross Income."

"Gross receipts," "gross income" and "net income," differ essentially from each other.

"Gross receipts" and "gross income" are phrases often loosely used, as if they were equivalent.

The former may include receipts from the sale of land or other capital assets. The latter, properly defined, cannot include such receipts.

> "Income, in its usual acceptation, is a loose and vague term; it applies equally to gross receipts and to net produce. But when the legislature had limited it to be synonymous with profits and gains, it became as clear and precise as any other word" [Vol. 8, Medical Journal, p. 229, (1802)].

Proper Definition of "Income."

> "Income" is "that which comes in as the periodical produce of one's work, business, lands or investment . . . annual or periodical receipts accruing to a person or corporation."
>
> *Murray's New English Dictionary (Oxford), under "Income."*

> "'Income' may be defined as *gain* derived from capital or labor or from both combined."
>
> Mr. Justice Pitney, *Stratton's Independence, L'd,* v. *Howbert,* 231 U. S. 399, 415.

Proper Meaning of "Net Income," As Defined by Income Tax Law Itself.

Receipts from sales of mined ore do not represent net income, wholly and exclusively. They represent, in part, depletion or loss of capital assets.

Aside from definitions of "net income" in the decisions, the Income Tax law itself defines "net income" thus:

> "Subject only to such exemptions and deductions as are hereinafter allowed, the *net income* of a taxable person shall include gains, *profits*, and *income* derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, businesses, trade, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property, also from interest, rent, dividends, securities, or the transaction of any lawful business carried on for gain or profit, or *gains* or *profits* and *income* derived from any source whatever, including the income from but not the value of property acquired by gift, bequest, devise or descent" (Sub-Section B of Section 2, Act of October 3, 1913).

The Act, upon its face, clearly shows the intention to define "net income" as *gains* and *profits*, and not to include therein *gross receipts* representing *losses*, by way of depletion of capital assets.

It would be contrary to the terms and the whole scheme of the Act, to attempt to tax anything beyond *gains* and *profits* arising from the sale of capital assets.

Yet the 5% clause necessarily involves a tax upon *all* the gross receipts, less operating expenses and this 5% deduction, which may be derived from the sale of ore, as if they were wholly income, when, in fact, largely capital.

Upon the facts above stated, the clause allows to this company an annual deduction of $150,000, whereas the real depletion of capital assets amounts to $700,000, or five times the amount allowed. In this case, capital assets,

to the amount of $550,000, have been taxed, as if they were income, when, in fact, principal.

In addition, the annual *gains, profits,* and *income* derived through the sale of copper, and amounting to $600,000 per annum, have been taxed as income, and properly so.

Stratton's Independence, L'd, v. Howbert (231 U. S. 399) furnishes no support for the Government's claim that sales of ore represent income wholly and exclusively and do not, in part, include depletion of capital assets or losses of principal.— It decides merely that such sales of ore do not represent depletion of capital assets wholly and exclusively.— It supports our claim that such sales, though partly representing gains and income, necessarily include capital or principal.— The five per cent allowance itself is based solely on the theory that principal is or may be depleted, to the extent of that allowance.— But, as this limited allowance is wholly inadequate, in the case of this or any other mining company, to replace the actual fair depletion and losses, the five per cent clause necessarily involves a direct tax upon a portion of the principal, as if it were income, and is, accordingly, unconstitutional, because not apportioned according to population.

The whole reliance of the Government must be rested on the decision in *Stratton's Independence, L'd,* v. *Howbert* (231 U. S. 399), for no other authority can be cited which, in any way, appears to sanction the theory that sales of ore represent "net income" *wholly* and *exclusively,* and do not cover *to any extent* the depletion of capital assets.

Differs Essentially from Case at Bar.

In the case at bar, it is specifically admitted that sales of mineral represent certain *gains, profits* and *net income,* which would be taxable under a properly drawn income tax law.

They also cover a certain amount of depletion of capital assets, and, therefore, to that extent, represent *losses* and partial exhaustion of principal.

The Act itself admits that this is so, but only to the limited extent of 5% of the annual *gross receipts* or " output."

If, as here, the 5% limitation does not make adequate provision for restoring the *whole* of the fair and reasonable losses and depletion, the necessary result is that the Income Tax directly taxes the capital assets of mines, to the extent of such inadequacy.

But, as shown by the Record, it is wholly impossible, under the 5% maximum limitation, to restore the depletion of capital assets, in the case of this mine or in any other case which may reasonably be suggested.

The *Stratton's Independence* decision, properly understood, directly supports the principles here contended for.

Extreme Claims in That Case Wholly Untenable.

The difficulty with the company's contentions in that case was that they were so extreme that this Court could not properly sustain them. It there claimed that the entire gross receipts from sales of ore, less operating expenses, represent principal or capital exclusively, and contain no element whatsoever of gain or *income;* and that, if they should be held to constitute *income,* depreciation should be deducted *to that exact amount,* because they represent wholly and exclusively the depletion of capital assets.

The obvious practical result of this contention was that, in no event, could a mining company become taxable at all, because, under no possibility, could it have any *net income* whatsoever.

That case arose under the Federal Corporation Excise law of August 5, 1909. The decision was strictly limited to the exact questions certified by the Circuit Court of Appeals.

These limited questions were presented upon an agreed statement of facts, which this Court clearly deemed to be unsupportable, as they were, in fact, because they were evidently based on an impossible theory regarding the nature of gross receipts derived from mining operations.

The company was a mining corporation, which extracted precious ore from its own mine. By the agreed facts, it appeared that its gross annual sales of ore amounted, for 1909, to $284,682.

The cost of extracting, mining and marketing the same amounted to $190,939.

The exact difference, or $93,743, according to the agreed facts, represented "the value of said ores so extracted in the year 1909, when in place in said mine, and before extraction thereof" (p. 406).

Questions Certified in That Case.

Three questions were certified, in substance, as follows:

(1) Does the Corporation Excise Tax law apply to mining companies at all?

The Court held that they are engaged in *business*, and are not merely engaged in transforming capital from one form into another, but, on the contrary, that mining operations involve, besides mere transformation and depletion of capital, an element of gain or income arising from the processes of mining and marketing.

(2) Are the proceeds derived from sale of ores *income*, within the meaning of the Act?

(3) If income, is the value of such ore in place, and before it is mined, deductible as depreciation? (p. 407).

The Court held that an *excise*, imposed for the privilege of transacting business in a corporate form, might properly be measured by either *net income* or *gross income* of a mining company, regardless of the fact that a portion of its gross receipts represents depletion of capital assets.

Upon this question, the Court clearly did not decide that *all* the proceeds from sales of ore represent " net income " wholly and exclusively.

It was sufficient, for the purposes of the case, to decide that a *portion* of such proceeds represented net income, as is obviously the case, and that it cannot legitimately be contended that *all* such proceeds constitute depletion of capital assets.

It may also be noted here that the Corporation Excise law provided clearly and specifically for the deduction of *all* losses and depreciation, thus measuring the excise by what is really the " net income."

The Income Tax law, on the contrary, by fixing the arbitrary maximum limit at 5% of the annual gross *output*, wholly prevents the determination of the *actual* " net income," for only a small fraction of the *real* losses, by way of depletion of capital assets, is thereby allowed to be deducted.

" Income " Directly Taxable, as Such, under Sixteenth Amendment, Involves a Different Question.

Moreover, it is expressly stated by the Court that the question here arising, as to what is " income," within the meaning of the Income Tax law, did not arise under the Corporation Excise Act:

> " As to what should be deemed ' income,' within the meaning of §38, it, of course, need not be such an income as would have been taxable as such, for that time (the Sixteenth Amendment not having been as yet ratified) income was not taxable as such by Congress without apportionment according to population, and this tax was not so apportioned " (p. 416).

Court Merely Held that Product of a Mine does Not Represent CAPITAL EXCLUSIVELY, but also Includes SOME Gains or INCOME.

The Court, speaking through Mr. Justice Pitney, states the effect of the decision thus:

> " The very process of mining is, in a sense, equivalent in its results to a manufacturing process. . . . The *gains derived from it are properly and strictly the income from that business; for 'income' may be defined as the gain derived from capital, from labor, or from both combined, and here we have combined operations of capital and labor. . . . It is of course true that the revenues derived from the working of mines result to some extent in the exhaustion of the capital*" (p. 415).
>
> ". . . The conduct of such business results in *profit*, for it *cannot be seriously contended that the ores are not worth more at the mine mouth than they were worth in the ground, plus* the cost of mining " (p. 416).
>
> ". . . In *Flint* v. *Stone Tracy Co.*, 220 U. S. 107, 165, it was held that Congress in exercising the right to tax a legitimate subject of taxation as a franchise or privilege, was not debarred by the Constitution from measuring the taxation by the total income, although derived in part from property which, considered by itself, was not taxable.
>
> " It was reasonable that Congress should fix upon gross income, without distinction as to source, as a convenient and sufficiently accurate index of the importance of the business transacted. And from this point of view, it makes little difference that the income may arise from a business that theoretically or practically *involves a wasting of capital*" (pp. 416, 417). . . .
>
> " We have no difficulty, therefore, in concluding that the proceeds of ores mined by a corporation from its own premises are to be taken as a part of the *gross income* of such corporation. Congress no doubt contemplated that such corporations, amongst others, were doing business with a *wasting capital*, and for *such wastage* they made due provision, in declaring that from the gross income there should be deducted (*inter alia*) 'all losses actually sustained within the year,' including a 'reason-

able allowance for depreciation of property, if any,' etc." (pp. 417, 418). . . .

"From that certificate it appears that the case was submitted to the trial court and a verdict directed upon an agreed statement of facts, and in that statement the gross proceeds of the sale of the ores during the year were diminished by the moneys expended in extracting, mining, and marketing the ores, and the precise difference was taken to be the value of the ores when in place in the mine" (p. 418). . . .

"The contention is that if the proceeds of ore sales are to be treated as *income*, the value of the ore in place and before it is mined is to be deducted as depreciation, and that such value is to be arrived at by the process indicated" (p. 418).

Commenting on the claim there made, the Court says (p. 419):

"It is clear that a definition of the 'value of the ore in place' has been intentionally adopted that excludes *all allowance of profit upon the process of mining, and attributes the entire profit* upon the mining operations to the mine itself" (pp. 419, 420).

" . . . In the first place, it is fallacious to say that, whatever may have been the original cost of a mining property or the cost of developing it, if in fact it afterwards yield ores aggregating many times its original cost or market value, this result merely proves and at the same time measures the intrinsic value that existed from the beginning" (p. 420). . . .

"It was, of course, contemplated that the income might be derived from the employment of property in business, and that this property might become more or less exhausted in the process; and because of this, a reasonable allowance was to be made for depreciation of it, if any. But plainly, we think, the valuation of the property and the amount of the depreciation were to be determined not upon the basis of latent and occult intrinsic values, but upon considerations that affect market value and have their influence upon men of affairs charged with the management of the business and accounting

of corporations that are organized for profit and are engaged in business for purposes of profit.

"And, secondly, *assuming the depletion of the mineral stock is an element to be considered in determining the reasonable depreciation that is to be treated as a loss in the ascertainment of the net income* of a mining company under the Act, we deem it quite inadmissible to estimate such depletion, as if it had been done by a trespasser, to whom all profit is denied" (p. 421) . . . . "[Here] the question is, — What is the income derived from the business? — and the incidental question,— What is the reasonable depreciation, if any, of the mining property?" (p. 422). . . .

"It would therefore be improper for us at this time to enter into the question whether the clause, 'a reasonable allowance for depreciation of property, if any' calls for an allowance on that account in making up the tax, where no depreciation is charged in practical bookkeeping; or the question whether depreciation, when allowable, may properly be based upon the depletion of the ore supply estimated otherwise than in the mode shown by the agreed statement of facts herein, for to do this would be to attribute a different meaning to the term 'value of the ore in place' than the parties have put upon it, and to instruct the Circuit Court of Appeals respecting a question about which instruction has not been requested, and concerning which it does not even appear that any issue is depending before the Court" (pp. 422, 423).

Chief Justice White and Justices McKenna and Holmes dissented in the decision as to the third question certified.

Fallacy in Claim that Sales of Ore Represent Nothing but Conversion of Principal.

The claim there made was that "if a part of the capital assets are removed and sold, the property, as it originally stood, is actually depreciated in value to the exact extent of such removal"; and that, "for every dollar of cash received, it relinquishes an equivalent amount of ore in place, and makes no gain or profit by the exchange" (p. 419).

This claim involves a fallacy.

It is true that every pound of copper extracted reduces the principal represented by the ore deposits, *pro tanto*.

If the mine has a forty-year life, one fortieth of the principal is exhausted yearly. But it does not follow, because *all* the yearly depletion is included in the selling price, that *all* of the proceeds of sales represent nothing but depletion.

The claim involves the further logical error that it overlooks the fact that two different valuations at distinct dates are compared.

It assumes that the net market value of the product, when mined and sold, is precisely equivalent to the value of the ore before extraction.

On the contrary, the market value of the product varies according to the date when sold, while the market value of the ore in place must be fixed at the date when the law took effect, in order to ascertain whether any *gain* or *profit* has been realized by the company for which it is taxable.

As the Court declared:

> " It cannot be seriously contended that the ores are not worth more at the mine mouth than they were worth in the ground, *plus* the cost of mining " (p. 416).

Yet this was the extreme claim made in that case and rejected by the Court.

This is the full effect of the decision, so far as it has any bearing here.

That case involved an *excise*, which might properly be measured by " gross income."

This is a direct tax on " net income," and nothing else can constitutionally be taxed directly, without apportionment.

There the Court held that, although a *portion* of the capital assets is covered by *gross income*, that fact does not impeach an excise measured by *gross income*, because sales do not represent principal *wholly* and *exclusively*.

There the Act provided allowances for the *full* amount of losses by depreciation or depletion.

Here the law arbitrarily limits the allowance to a *portion* of such losses, and, indeed, a small fraction of the actual reasonable losses.

"Net income" is the gain or profit derived from the use of capital, without impairment thereof. — Unless the principal is left intact, by proper allowances for losses, depreciation and depletion of capital assets, the proceeds from sales of mining products cannot represent "net income" wholly and exclusively.

This tax is levied on "net income."

Decisions as to the proper definition of "income" or "gross income" have no material bearing here, although it is generally recognized that nothing can be *income* unless it represents a *gain* or *profit*. If it represents a *loss* of capital assets, that must first be restored or allowed for, before any *income* can result.

> "'Income' may be defined as *gain* derived from capital or labor, or from both combined."
>
> *Stratton's Independence L'd* v. *Howbert*, 231 U. S. 399, 415.

> "Income, as contrasted with capital, denotes the amount of wealth which flows in during a definite period, and which is at the disposal of the owner for purposes of consumption, so that in consuming it his *capital remains unimpaired.*"
>
> *Seligman, Income Tax*, Sec. 5.

> "A proper definition of the word 'income' would be, all that a man receives in cash during the year, except such sums as are merely *capital or principal in a changed form;* that is, excluding sums which are merely the proceeds of some other form of capital converted into cash."
>
> *Black Income Tax*, Secs. 32, 34.

See

Spooner v. *Phillips*, 62 Conn. 362.

Nipissing Mines Case, 202 Fed. 803.

In the *Nipissing Mines* case (202 Fed. 803), it was held that the fair value of ore, in place, represents *principal*, and must first be deducted from *gross income* or *gross receipts* before any " net income " can possibly arise, under the Federal Corporation Excise.

The company was a holding company, owning the entire stock of the Nipissing Mining Company.

Judge Lacombe, delivering the opinion of the Appellate Court, says:

> " Certainly so much value has been eliminated from the property of the company forever. Granting the proposition that such is a reasonable allowance for depreciation, upon the figures here there is no net profit remaining. . . .
>
> " If the *known value* of an ore bed were exactly $2,000,000, and exactly $500,000 were taken out of it each year, in four years there would be nothing left.
>
> " It is difficult to say why it may not reasonably be said that the ore bed suffers each year a depreciation of $500,000, just as a $10,000 piece of machinery, with a life of ten years, suffers a depreciation of $1,000 each year.
>
> " As I read the statute, Congress intended to allow all reasonable depreciations to be deducted from the gross profits, to find the net; and the reasonableness of any deduction asked for, depends upon the nature of the claim on which it is based, not upon the amount of dollars it may aggregate.
>
> " Nor is it apparent why it should make any difference that one cannot tell, with reasonable certainty, the total value of the deposit, so long as the value of the amount removed in any one year can be ascertained with sufficient accuracy.
>
> " Nor is it apparent why the problem is altered in any way by the circumstance that the property was bought at a very high or at a very low price, or that the capitalization of the company which owns it is large or small."

Illustrates fallacy in Stratton's Independence Case.— If unmined value of deposits is known, any reduction in known value is capital.— There assumed that sales of ore represented known value of unmined deposits exclusively, whereas they partly represent income.

The illustration as to the removal of $500,000 yearly out of the *known value* of an ore bed suggests the fallacy of the extreme claims advanced in the *Stratton's Independence* case.

If the value of the ore deposits, in place, is actually *known*, or can fairly be estimated, and $500,000 is taken away from the *known* value yearly, the *value* thus deducted is *all* capital, because it represents the value of the ore in place.

But it does not follow that, when sold, the product will not yield a profit above its $500,000 capital value, as an unmined deposit.

Obviously, as Mr. Justice Pitney observed (*supra*), it will sell at a profit.

Here the unit value of the unmined deposits in place is 3½ cents per pound. The net income is the same amount, with copper selling at its average price of 15 cents. The net receipts above operating expenses, accordingly, represent depletion of capital, to the extent of " one half or more of the entire net receipts," the remaining half constituting taxable " net income."

We have here a *known value* of the unmined ore deposits, in place, or a fairly ascertainable market value thereof, which has been determined in accordance with governmental requirements.

Whether our values are excessive or not can be determined only upon a trial, but they are admitted by demurrer.

Even if we could not prove the full amount of value claimed, the undoubted fact remains that *some portion* of our capital assets is taxable, under the 5% clause, beyond the amount allowed for deduction. And this is the natural or inevitable result of such a provision.

As the clause authorizes, indeed, requires the direct taxation of *some portion* of the capital assets, besides " net income," the tax is unconstitutional, as applied to mines, because not apportioned.

Von Baumbach v. Sargent Land Co., 207 Fed. 423; 219 Fed. 31.

A similar question was passed upon in *Von Baumbach* v. *Sargent Land Co.*, where it was held that gross receipts of the owner of a leased iron mine, from royalties paid by the lessee, are not wholly income, under the Federal Corporation Excise, but, in part, if not wholly, represent the conversion of capital assets into cash.

In the court below, Judge Willard said:

> " I believe that the ordinary meaning attached to *income*, when it is not derived from personal exertion, is that it is something produced by capital, *without impairing* that capital, and *which leaves the property intact*, and that nothing can be called *income* for the purpose of this act, which *takes away from the property* itself.
>
> " If it does, then it ceases to be income, and amounts to a sale of capital assets. . . .
>
> " That *ore in place is capital, and is part of the real estate, I think admits of no question.* It is just as much a part of the real estate as trees standing on the land. . . . They are both capital, and money derived from a sale thereof cannot be considered *income*, whether it be money received from the ore, or money received from the timber " (p. 432).

Stevens v. Hudson's Bay Co., 101 L. T. Rep. 96.

In *Stevens* v. *Hudson's Bay Company* (101 L. T. Rep. 96) it was held that annual receipts from sales of the company's lands were not liable to the English Income Tax.

Under an act of 1868, the company had surrendered to

the Dominion of Canada the lands held under its original charter of 1670 and the privileges of the "Governor and Company of Adventurers of England trading into Hudson Bay," in consideration of 300,000 pounds, in cash, and of the right to select, from time to time, one-twentieth of the fertile lands so surrendered.

The company had selected and sold such lands at various times, and the sums received therefor were claimed to be taxable, as income.

Farwell, L. J., there says:

> "It is well settled that income, *not capital*, is taxable under the income tax acts. . . .
>
> "Income is not the less income, for the purposes of income tax, because it is produced by embarking capital in a wasting subject matter — e. g., in buying and working mines; *nor, on the other hand, does an annual sum become income merely because it is paid annually.*
>
> "If it be, in its inception, and not by adjustment and subsequent recoupment, composed partly of capital and partly of income, then the tax is chargeable only on so much as is income. . . .
>
> "It is clear, therefore, that a man who sells his land, or pictures, or jewels, is not chargeable with income tax on the purchase money, or on the difference between the amount that he gave and the amount that he received for them. But if, *instead of dealing with his property as owner*, he embarks on a trade in which he uses that property for the purposes of his trade, then he becomes liable to pay, not on the excess of sale prices over purchase prices, but on the annual profits or gains arising from such trade, in ascertaining which, those prices will, no doubt, come into consideration. . . . The actual claim by the Crown in the present case is extravagant, for it is for the whole of the purchase money. If the company were to be treated as trading, they must, at least, be allowed the price paid for the land."

Exhaustion of Ore Deposits by Sale of Product does Not essentially Differ from Sale of Land at a Purchase Price Payable in Yearly Instalments.

It should be noted that exhaustion of the value, in place, of ore deposits, through mining and sale, differs, in no essential respect, from the sale of a mine or other parcel of real estate for a consideration payable in yearly instalments covering a long term of years. We admit the income element involved in sales of the product, aside from the conversion of principal also covered by the receipts. But the interest element involved in yearly instalments of purchase money, is quite similar to that phase of ore sales.

Secretary of State for India v. Scoble, 89 L. T. Rep. 1.

Secretary of State for India v. *Scoble* (89 L. T. Rep. 1) involved such a question.

The Government exercised its power, under a contract, and purchased a railroad, electing to pay the purchase money in semi-annual instalments, covering a period of forty-nine years.

It was held that such instalments were not taxable as *income*, or as an *annuity*, under an Act imposing a tax " for and in respect of all profits arising from interest, *annuities*, dividends, and shares of annuities payable out of any public revenue."

Lord Halsbury there says:

> " Was it the intention of the income tax acts ever to tax capital as if it was income? I think it cannot be done, both upon the language of the Act itself, and upon the whole import and meaning of the income tax acts, and that it never was intended to tax capital, at all events as income. . . . You start upon the inquiry into the matter with the fact of an antecedent debt which has got to be paid; and if these sums, which it cannot be denied are partly in liquidation of that debt which is

due, are to be taxed as if they were income in each year in which the payment is being exacted, the result is that *you are taxing part of the capital.*"

Foley v. Fletcher, 3 H. & N. 769.

Foley v. *Fletcher* (3 H. & N. 769) involved the precise question as to the purchase price of a mine, payable by annual instalments, during a long term of years, which were, presumably, somewhat enhanced by the interest element. A coal mine was sold under a contract providing that 99,000 pounds, the purchase price of the plaintiff's interest, should be paid to her in semi-annual instalments, covering a period of thirty years.

It was held that such instalments represented *capital*, and were not taxable under the law imposing an income tax upon " all annuities, yearly interest of moneys, or other annual payments."

Counsel contended that these instalments were profits, because they included an interest element, for, when the protracted period was considered, it could not be assumed that the value of the plaintiff's estate was in excess of one half the amount agreed upon as the purchase price.

In answer to this claim, Pollock, C. B., says:

> " But if we were at liberty to speculate on the matter, and could come to the conclusion that part of the annual payments is the price of the convenience of getting the payment postponed, we could not say that the payments were within the act because a part of them consists of profits.
>
> " These instalments are payments of money due as *capital;* the act made no provision for such a case.
>
> " It professes to charge profits only, and *we cannot say that capital is liable because found in company with profits.*"

Baron Bramwell, concurring, says:

"It cannot be taken that the legislature meant to impose a duty on that which is *not profit derived from property, but the price of it.* . . . Mr. Phipson's argument would show that it would be reasonable the payment should be divided into two parts, principal and interest."

Baron Watson, in his concurring opinion, says:

"It is a startling proposition that income tax attaches upon debts payable by instalments." . . . "Then again it is said that these payments are compounded of interest and principal.

"Possibly profit is obtained by the postponement of the payment, but the Court cannot say that any part of it is interest."

Valuation of This Mine Excludes All Interest or Profit on the Yearly Instalments, Representing, in the Aggregate, the Total Original Market Value of the Unmined Ore, in Place.

Here we expressly admit that receipts from sales of copper are "compounded" of principal and income, including an interest element, for only one half of the net receipts (Rec. 3) is claimed to represent principal, the remaining half being taxable as "net income."

The unit value adopted in our valuation resulted in fixing the immediate market value of the ore deposits, in place, if sold *en bloc*, at $28,000,000, whereas yearly instalments of $1,400,000, covering a period of forty years, would yield $56,000,000 in net receipts.

The interest element included in annual instalments, covering a long period, has been fully allowed for in our valuation.

We are content to pay an income tax based on our actual fair "net income," excluding, however, such portion of the *gross income* as fairly represents depletion of capital assets.

The market valuation of the ore in place was fixed prior to the passage of the Act. The capital assets can neither increase nor diminish in value, so far as the Income Tax is concerned. The changing prices, realized on sale of the copper, produce a profit and gain, which become taxable as " net income."

The annual deduction of one fortieth of the market value of the ore deposits, in place, results in the conversion of the principal, at its original capital value, into cash, at the end of forty years, when the mine will become wholly exhausted.

The problem is precisely the same as if the mine had been sold, prior to the passage of the Act, at the market value of its total ore deposits, in place, the purchase price being made payable in forty annual instalments without interest.

The above cases establish that instalments, so payable, represent *principal*, and not income.

Merchants' Insurance Co. v. McCartney, Fed. Cas. No. 9, 443.

Another close analogy is presented by a case involving surplus profits accumulated before passage of an income tax. *Merchants' Insurance Co.* v. *McCartney* (Fed. Cas. No. 9, 443) arose under the Income Tax of 1864.

An insurance company, being a stockholder in a bank, received a dividend therefrom, three tenths of which was declared out of profits accumulated prior to the passage of the Income Tax.

The Court held that the tax on the dividends which represented accumulated profits, was a tax on *principal*, and not on " net income."

Judge Lowell there says:

> " As to the three tenths, it seems to me to have been a *division of capital*, a *return* to the plaintiffs, in money,

of a *part of the property* which was already in their ownership as capital stock when the first tax act was passed.

" If the Suffolk Bank had been wholly wound up and had returned to its stockholders the exact value of their shares in money, having made no profits since the passage of the original act, this sum of money could not be taxed as income, gains or profits; and so of a part.

" If the plaintiffs on receiving the money chose to divide it among their own stockholders, still it is not a dividend out of gains and profits, nor out of the surplus funds, because the surplus funds that are taxable are those which are or have been made out of profits, since the passage of the Act."

Commonwealth v. Central Transportation Co., 145 Pa. St. 80.

Commonwealth v. *Central Transportation Company* (145 Pa. St. 80) involved a similar question.

A sleeping car company, prior to the passage of an income tax, transferred its assets to another company, in consideration of an annual rental, which was distributed, when received, to its stockholders, by way of dividends. It determined later that it was advisable to retain a portion of the annual rental, for the purpose of providing a fund whereby the corporation might resume its original business, if necessary. It was afterwards decided to distribute a portion of this accumulated fund among its stockholders.

Such a division was held to be a distribution of *capital*, and not of income, quite irrespective of the fact that the capital stock was simultaneously reduced by an equal amount.

As the Court says:

" The fund in question plainly represented *capital*, was expressly and consciously accumulated as capital, was intended to be used as capital, and, when this intention was abandoned, was expressly divided as capital.

" It is true that it was sometimes loosely spoken of

as a 'surplus' and the reduction as a 'dividend'; but the transaction is to be regarded as it really was, and not as it may have been incorrectly named."

Gibson v. Cooke, 1 Met. 75.

In *Gibson* v. *Cooke* (1 Met. 75) a trust estate included land which was condemned by a railroad company. Damages for the taking were paid to the trustee. It was held that the beneficiaries could not compel distribution of the land damages to them, as income of the trust estate.

Shaw, C. J., says:

> "The money received as damages is to be regarded as *capital* substituted, by act of law, in the place of the land taken."

The Government has fully endorsed our claims, under the Federal Corporation Excise, by ruling that even "gross income" cannot properly be ascertained, without first deducting ample allowance to cover ALL depletion of capital assets.

While the Government is not bound by the interpretation placed by the Treasury Department upon the phrase "gross income," in the preceding Federal Corporation Excise, we may fairly present the Treasury view as expert evidence, of the highest character, supporting our claim that even "gross income," and still more clearly "net income," cannot possibly be ascertained, unless a reasonable allowance has first been made, to cover *all* depreciation and depletion of capital assets.

The same phrases are also used in the Income Tax, with the single exception, applicable only to mines, that the maximum limit of such deduction is arbitrarily fixed at 5% of the annual gross receipts or "output."

Under the Treasury Regulations issued on February 14, 1911, elaborate provision was made for the proper val-

uation of ore deposits, in place. It was distinctly provided that the capital value of ore mined in any year, as thus determined, might be wholly excluded from " gross income."

Our valuation was thus determined.

Paragraph 83 of this circular provides that an estimate should be made of the fair market value of the ore deposits, in place, as of January 1, 1909.

This estimate was to be made on the basis of the disposal value of the total ore deposits *en bloc*, exclusive of the value of improvements and development work.

Paragraph 84 provided:

> " The *unit value*, as of January 1, 1909, ascertained as above outlined, would indicate the value to be attached at that date to the *capital assets* disposed of during any calendar year succeeding," etc.

Paragraph 85 continues:

> " Values, as stated, as determined at January 1, 1909, should be used in compilation in all subsequent years' excise tax returns.
>
> " The question as to whether it subsequently develops [that] the property possessed a greater quantity of mineral, etc., reserve than was, in the aggregate, estimated as of January 1, 1909, is immaterial.
>
> " Any excess which may be developed will be considered as possessing the same value at January 1, 1909, as that which then may have been known to be in the property."

These Regulations present the correct view, as to restoration of depleted capital assets before even " gross income " can properly be ascertained.

The Government has now taken a totally different view, in a tax on " net income," by inserting the special 5% depletion clause, applicable to mines alone.

Even under the present law, all other corporations, except mining companies, are specifically allowed deduction for their *full* losses arising from sale, depreciation and depletion

of capital assets. (Treasury Regulations of January 5, 1914, Arts. 109, 128, 111, 134, 135, 137, 138, 139.)

Cases which may be cited, as appearing to establish the contrary doctrine, have no real bearing upon the question here presented.

We assume that the contention of the Government will be that the entire gross receipts, less operating expenses, which are derived from the sale of products of a mine are *net income*, subject to the 5% deduction. For this is the only theory which can support the Government claim that this Act, as applied to mines, is constitutional, because, if *any part* of such receipts is taxable which represents *capital*, the whole tax must fail, for the reason that capital and income are indistinguishably mixed.

But this theory is flatly contradicted by the terms of the Act itself, which allows a limited deduction for depletion of ore deposits, simply and solely *because* they represent losses of *capital* or *principal*. The Government can hardly take refuge in the technical claim that it admits that 5% of the gross receipts constitute principal, and the remainder income. No reason can be suggested for drawing the line arbitrarily at this point. It cannot be shown that 5% of the annual *gross receipts*, or " output," is an adequate allowance to replace lost capital, under any reasonable state of facts which may be suggested.

The facts admitted by demurrer prove it to be wholly inadequate and unjust, as applied to this company.

We assume that the Government's contention must still be what was claimed in its behalf in the *Stratton's Independence* case (231 U. S. 399).

The Government, apparently, will admit, as it did there, that ore deposits, in place, constitute *principal* or *capital*, but will claim that, when mined, a " flow " begins, which " necessarily changes its character from capital to income."

Great reliance is, apparently, placed on the metaphorical definition in *Waring* v. *Mayor* (60 Ga. 100):

> "The fact is: property is the tree, income is the fruit; labor is the tree, income the fruit; capital the tree, income the fruit."
>
> "The fruit, if not consumed as fast as it ripens, will germinate from the seed which it encloses, and will produce other trees and grow into more property, but so long as it is fruit merely, and plucked to eat, and consumed in the eating, it is no tree, and will produce itself no fruit."

See, however, the distinction plainly stated by the same Court between capital assets and income, in a later case.

Mundy v. *Van Hoose*, 104 Ga. 625.

The illustration might be more apposite, if the tree itself were cut down or removed and sold.

It is not apparent why, merely because the product is "consumed," it necessarily becomes income, for principal may as readily be consumed, as in the case of stripping a timber lot.

The Government's brief in the *Von Baumbach* case, attempting to apply the above definition of the Georgia Court, proceeds:

> "The argument that, since this flow necessarily results in depletion and exhaustion of capital, therefore the flow is a flow of capital, and not of income, is entirely fallacious, according to the above definitions, the understanding of business men, and the practical necessities of a tax based on income.
>
> "The law takes things as it finds them; it taxes property under the character which the owner has impressed on it, and where that owner voluntarily changes his fund of capital into a flow of income, the law accepts the designation, and taxes him accordingly."

Admitting the fallacy of the company's extreme claim in the *Stratton* case, it is equally fallacious to argue simply because the property has been converted from a "fund"

into a "flow," that it is, therefore, a flow *wholly of income*, and not at all of capital.

The truth lies between. The flow represents *partly principal* and *partly income*.

Nor is it apparent upon what ground it may be assumed that the owner "voluntarily changes his fund of capital into a flow of income," when he merely converts his capital assets into cash. Some income, as here, does, in fact, result from the conversion. But whatever was the *capital value* of the ore deposits, when in the ground, remains *capital*, even when converted into cash.

The confusion of thought results from not appreciating that the separate values of ore *in the ground* and *at the mine mouth*, differ essentially, and are not confined to the mere difference covered by the cost of extraction, as pointed out in the *Stratton* case by Mr. Justice Pitney (p. 415).

The mined product, when sold, produces income, as well as resulting in the conversion into cash of the *original unmined* value of the ore deposits.

Stratton decision (231 U. S. 399) not conclusive here, because it merely decided that sales of mining products do not represent PRINCIPAL wholly and exclusively.—Here it is expressly admitted that, in part, they cover net income, as well as the conversion of capital assets into cash.

The *Stratton* case is not here decisive, as claimed. The limited effect of that decision has already been fully stated.

Cases taxing annuities, as income, have no material bearing here, because there the principal has wholly ceased to exist.—Here the capital assets are transformed, by periodical instalments, into cash, representing partly principal and partly income.

There is no proper analogy between the conversion of capital assets, like ore deposits, into cash, by annual instalments covering a long term of years, and annuities, which are properly taxable under an income tax.

A much closer analogy is the case of selling land, the purchase price of which is payable in instalments, covering a long term of years. Such instalments represent *principal*, and are not taxable, under an income tax, as is well settled by the cases above cited.

Annuities, on the contrary, do not exactly equal, at the end of the term, the amount of cash expended in their purchase.

They profess to include ordinary interest or income on the investment, as well as payments of extra income, to cover the loss of principal and the contingencies of life.

Like the purchase of a bond, the owner has chosen to convert his cash into an income-bearing security, where, of course, the income is taxable.

In the purchase of an annuity, the cash principal has completely disappeared.

> " An annuity means where income is purchased with a sum of money, and the *capital has gone* and has *ceased to exist*, the principal having been converted into an annuity."
>
> *Foley* v. *Fletcher*, 3 H. & N. 769.

In that case, an annuity was held not to be analogous to a case where land is sold at a purchase price payable in instalments.

Cases have no application which hold that mining companies may distribute dividends to their stockholders out of their annual net receipts. Mining dividends are distributable, although largely capital, because such action is contemplated by purposes of the charter.

It is well settled that mining companies constitute an exception to the general rule that corporations may declare dividends only out of net earnings, because the very object for which the corporation is formed, contemplates the gradual exhaustion of its capital, consisting of ore deposits.

Morawetz Corporations, Sec. 442.
People v. *Roberts*, 156 N. Y. 385.
Excelsior Co. v. *Pierce*, 90 Cal. 131.
Lee v. *Neuchatel Co.*, L. R. 41 Ch. Div. 1.

In *Lee* v. *Neuchatel Co.* (*supra*) it was sought to restrain payment of dividends derived from sales of the products until the wastage had been made good which resulted from the working of an asphalt mine.

The Court held that the English Companies' Act does not prohibit a corporation organized for the purpose of operating a wasting property, like a mine, from distributing its net receipts, although they largely represent capital, and not income, because exhaustion of principal was the business contemplated by the company. The only conceivable argument which can be based on this exceptional doctrine as to mining dividends is that because the proceeds from sales of ore are distributable periodically, they necessarily constitute net profits, and not principal.

No such conclusion logically follows.

It might equally be urged that, because the purchase price of land payable by instalments, covering a long period, is distributed annually by way of dividends, it follows that such instalments represent income, and not principal.

But such instalments are not taxable under an income tax.

Foley v. *Fletcher*, 3 H. & N. 769.
Secretary of State for India v. *Scoble*, 89 L. T. Rep. 1.
Stevens v. *Hudson's Bay Co.*, 101 L. T. Rep. 96.

The proper conclusion from the doctrine as to mining dividends, is that they are distributable, notwithstanding the fact that they represent capital assets. They constitute principal, even though they are called "dividends."

Cases arising under wills or trusts, and involving rights of life tenants in mining properties, have no proper application here. They rest on the terms of the trust.

Various cases have arisen under wills or trusts which have turned on the question of the testator's intention, and, therefore, have no bearing here.

In *Daly* v. *Beckett* (24 Beav. 114) the widow had the right, under a deed of trust, to receive the " rents and profits " of certain coal lands, during her life, with remainder to her children. The deed of trust expressly authorized the trustee, by direction of the widow, to lease the mineral lands for the best rents obtainable.

Under a lease the trustees received a yearly royalty payment. The Court held that this payment must be regarded as income payable to the life tenant, and not capital to be invested for the benefit of the remainder-man.

The Master of the Rolls (Romilly) there says:

> " All the authorities establish this: that the produce of the mines is made part of the annual profits of the estate, and that whether in royalties or in whatever other way it is produced, it forms part of those profits, and that it is not to be treated like timber cut, where the produce of it is invested and the interest only is paid to the tenant for life."

This decision was rested upon the intention of the grantor, for the authority to make mining leases, at the direction of the life tenant, was obviously conferred for the express purpose of creating an annual income for her use.

In *Eley's Appeal* (103 Pa. St. 300), the trustees, under express authority to make mining leases given by the will, executed a lease of a coal mine at an annual royalty.

The life tenants were to receive all the " interest or income " of the trust estate.

The question, as stated by the Court (p. 306), was " whether the money accruing from the lease is to be considered income *in the sense in which that word was employed by the testator*, or capital to be invested." The Court held that it was *income*, stating that it would be a " strained and

unnatural construction of the will, to hold that he intended to give appellants only the annual interest on the instalments of rent."

This decision has no general application, but, on the contrary, expressly departs from the established doctrine (p. 306) in that jurisdiction, to the effect that a mining lease is practically a sale of the ore in place, and, consequently a sale of a portion of the realty.

Other similar decisions, arising under wills or trusts, rest purely upon the construction of the particular instrument, as indicating the intention of the testator.

> *McClintock* v. *Dana*, 106 Pa. St. 386.
> *Appeal of Shoemaker*, 106 Pa. St. 392.
> *Raynolds* v. *Hanna*, 55 Fed. 783; 59 Fed. 923.

Taxation cases cited have no importance here, as they arise under laws totally different.

The case of *Gay* v. *Baltic Mining Co.*, decided in connection with *Flint* v. *Stone Tracy Co.* (220 U. S. 107), seems to be relied on, but has no bearing here.

It decided nothing beyond what was covered by the *Flint* case, which decided that an *excise* on the privilege of doing business in a corporate form might properly be measured by "gross income," regardless of the fact that it might be derived from Government bonds or other property non-taxable in itself.

The same principle would apply even if the measure adopted covered, in part, receipts derived from the sale of capital assets, but even this question was not really involved in the *Gay* case, because the Federal Corporation Excise and the Treasury Regulations thereunder made the fullest provision for deducting *all* losses from "gross income," whether arising through depletion of capital assets or otherwise.

The decision, in any event, goes no further than the *Stratton* case.

Coltness Iron Co. v. *Black* (L. R. 6 App. Cas. 315) seems, at first sight, to present a similar problem, but it really involved a direct tax on *property*, and not what professed to be an income tax, as here, nor an excise tax measured by gross income, as in the *Flint* case.

A deduction of 9,027 pounds from the annual property tax was there claimed, because of capital expenditures made in sinking new mine pits, upon the ground that they should first be deducted from the gross receipts before the profits for the year could be properly ascertained. The law there involved (5 and 6 Vict. c. 35) was totally different from the Income Tax Act.

It specifically provided that mines should be assessed as "property," the annual value of coal and iron properties, for purposes of such taxation, being ascertained by taking the average "profits" received therefrom during five years preceding.

For the purpose of estimating the "profits," the Act specifically directed that no sums should be deducted on account of expenditures for *repairs* to the premises, or for any *capital* employed in *improvements* of premises occupied for purposes for such trade, manufacture or concern; and that it should not be lawful to make any deduction from gains or profits arising from any property on *account of diminution of capital employed*.

The 9,027 pounds claimed was not an actual expenditure, but was estimated by calculating certain amounts per ton of iron made or coal sold, as representing the proportionate expense per ton of all pits and bores on the premises.

It was a case involving improvements and alterations, and not, as here, a case of depletion of capital assets owned before the Act took effect.

Earl Cairns stated the question involved thus (p. 324):

> "Can a mine owner write off and deduct from the gross earnings of his mine in a particular year a sum to represent the year's depreciation of all the pits in the mines, *whenever sunk?*"

Obviously, sufficient pits might be sunk in a particular year to open the mine for ten years in the future.

Lord Penzance stated (p. 326) that "profits received therefrom," as used in the Act, meant, in the connection in which they were used, "the entire profit derived from the mine, deducting the cost of *working* it, but not the cost of *making* it."

Lord Blackburn concluded that the purpose of Parliament was clearly to measure the property value of mines by that which is produced from them.

Earl Cairns and Lord Blackburn both declined to decide that expenditures for sinking pits might not lawfully be deducted, under certain conditions, but merely decided that the sum claimed, as calculated, was not properly deductible.

Commonwealth v. *Ocean Oil Co.* (59 Pa. St. 61) and *Commonwealth* v. *Penn Gas Coal Co.* (62 Pa. St. 241) have no importance here, even if correctly decided.

Oil companies were there held assessable on their entire net receipts, after deducting only operating expenses.

The claims of the companies were even more extreme than that advanced in the *Stratton* case, and were to the effect that the nominal capital stock of the company, largely over-capitalized, as was assumed by the Court, must be restored out of the gross receipts before any income could arise, with the practical result, as the Court states, that "the whole annual income would have to be retained to supply the loss of capital, which should disappoint the stockholders of their dividends and the State of its taxes."

In any event, if these cases were correctly decided, the ground for decision is obviously unsound, as stated in the *Ocean Oil* case:

"The present company *pays dividends*, which are, of course, *its net earnings or income*, whether declared or not, which the State intended to tax."

The same Court subsequently took the contrary view as to the proper effect of calling a distribution a "dividend," in *Commonwealth* v. *Central Transportation Co.* (145 Pa. St. 80), where the Court says:

"It is true that it was sometimes loosely spoken of as a 'surplus' and the reduction as a 'dividend'; but the transaction is to be regarded as it really was, and not as it may have been incorrectly named. Its truth and substance were as we have found above."

As this feature is stated by Judge Willard:

"I attach no importance to the fact that the company used the word 'dividends' in making this distribution. If the money was not gross income, the fact that when they distributed it they called it *dividends*, could not in any sense change the law as to what the real character of the money was."

Von Baumbach v. *Sargent Land Co.*, 207 Fed. p. 423.

People v. *Roberts* (156 N. Y. 385) merely decided that the surplus of a mining company, invested in stocks and bonds, was not a part of the "capital stock," by which the tax was measurable, but was surplus, which might be distributed to the stockholders.

It is clear that Congress cannot directly tax principal, calling it "income," when it is not such, in reality.

As has been said:

"It may be conceded that things which are not, in fact, *income* cannot be made such by mere legislative fiat."

Income Tax Cases, 148 Wis. 456.

We submit that no case can be found which decides that sales of ore from a mine, or the depletion of wasting assets of any other kind, represent *income, wholly and exclusively.*

On the contrary, it is clear from the decisions above cited, and particularly the *Stratton* case, and, in any event, from the facts stated in this record, that sales of copper represent *partly capital* and *partly income.*

Although the exact amount of capital represented by such sales is not here important, it is unquestionable, under the facts stated in the bill, as well as by the inevitable results of such a provision, that the 5% maximum limit based on the annual *gross income* or " output " of mines is not, and can never constitute, an adequate allowance, to represent the fair and reasonable annual depletion of ore deposits.

The result is that, to the extent of such inadequacy, the principal or capital of mines is directly taxed, and, indeed, to a very large amount.

Being direct taxation of property, other than income, without apportionment, the Income Tax, as applied to mines, is not authorized by the Sixteenth Amendment and is, therefore, unconstitutional and void. In any event, the 5% depletion clause, applicable only to mines, is unconstitutional, being separable from the rest of the Act.

Depreciation, depletion and losses must be allowed for in any income tax. — Unless allowed for, the tax is not limited to income, but also covers a portion of the principal — and this is true, not merely of wasting properties, like mines, but also of all kinds of depreciable property.

It has been sufficiently shown that the 5% clause, in its natural, or even necessary, operation and effect, taxes *some portion* of the capital assets ot a mine directly and without apportionment.

But our contentions would have a more general application, except for the fact that this Income Tax specifically allows to all other classes of corporations and all individuals,

except mine owners, the fullest right to deduct their *entire* losses, depreciation and depletion, before arriving at taxable " net income."

We submit that this was not a voluntary favor granted by the Government, as a mere matter of fairness and justice, but an indispensable prerequisite to the constitutionality of such a tax.

This is not a necessary part of our case, but, if sound, throws additional light on our contentions as to mining properties.

The Sixteenth Amendment only authorizes direct taxes on " incomes."

This language presumably means *net income.*

But whether or not it would be held also to cover direct taxes upon " gross incomes," we submit that it is self-evident that a so-called " income tax " which made no provision whatsoever for deduction of losses of capital assets or for depreciation of plant, could not possibly be regarded as a tax purely upon *income*, for it necessarily would also cover *some portion* of the *principal.*

Suppose that this Income Tax law had provided that individuals and corporations might deduct from their gross receipts only one fifth of their actual fair losses or depreciation. Could it reasonably be contended that a tax on the remaining four fifths was not in reality a tax on *principal*, although called a tax on " net income "?

But this is precisely the *real effect* of the 5% clause, when the " substance " of the thing is reached. This Court always endeavors to look through mere forms (*Flint* v. *Stone Tracy Co.*, 220 U. S. 107, 163; *Western Union Telegraph Co.* v. *Kansas*, 216 U. S. 1).

What is Depreciation?

Everything " depreciates," though in different degrees and ways. The derivation of the word (*de* and *pretium*)

sufficiently indicates its meaning. It is a taking away from or diminution of the price; consequently a "reduction in value" (see Murray's New English Dictionary, under "depreciate").

As used by Blackstone (2 Black. Comms. p. 282):

> "Whatever tends to the destruction, or depreciating the value of, the inheritance."

The essential nature of *depreciation* is not different, whether we apply it to a manufacturing plant or to wasting properties, like mines, timber lands or patent rights and call the process "depletion."

In the one case the principal may remain in its original physical shape, but in a deteriorated condition; in the other, a portion of the physical mass may have been extracted and removed. In either case there is a reduction in market value of capital assets.

This is the essential feature.

The exact method by which it is brought about is an immaterial factor. Whether we call the process "depreciation" or "depletion," is unimportant. In any event, it is a *loss*.

This is expressly recognized by the terms of this Act, which grants the right to deduct all "*losses*," including "depreciation," and "depletion," to a limited extent, in the case of mines.

Nor, in its essence, does "depreciation by use, wear and tear of property" differ from other kinds of depreciation or from depletion.

Each and all represent *losses* in market value of the principal, precisely like partial or total losses of property through fire.

If the 5% clause for "depletion" of mines had been completely left out, mines and all other classes of corporations could probably have allowed for wastage of capital assets, under the provision for deducting "all losses,"

and including a "reasonable allowance for depreciation by use, wear and tear of property." (See *Stratton's Independence* case, 231 U. S. 399, 417, 418, 421, thus interpreting similar language in the Federal Corporation Excise.)

The addition of the clause arbitrarily converts "losses" into *gains* or profits, thereby taxing what, in fact, is principal as if it were income, for, as already shown, the real and necessary effect of such a provision is to tax directly *some portion* of the capital assets of mines, as if it constituted a *gain*, instead of a loss.

What is "Net Income" of a Mine?

The annual proceeds from sales of ore, constituting "gross receipts," are first subject to the deduction of operating expenses.

Against the balance, should be set off the reasonable depreciation or depletion of the mine.

What is *reasonable depreciation?*

If the unmined ore deposits, in place, are fairly worth, in the market, a certain sum at the beginning of the year, and a less sum at the end of the year, the difference represents the reduction in market value, or *depreciation* during the period.

Such decrease in market value of capital assets must be allowed for, like any *loss*, before any "net income" can possibly be shown.

Reasonableness of Depreciation Charge.

The exact means of determining a fair depreciation or depletion allowance, is not important. Methods differ. Expert judgment must be relied on, precisely like other more or less complicated property valuations. A mine differs somewhat, because no one can see into the ground.

But the history of Michigan copper mines shows conclusively that their ore bodies are persistent at fairly constant values, to great depth, quite different from ore deposits in some other localities.

Experts have adopted methods which result in a fair approximation of the present selling value of unmined deposits, upon the basis of "considerations that affect market value," and not of "latent and occult intrinsic values." (See *Stratton's Independence* case, 231 U. S. 399.)

Such modes of valuation, involving measurement of the "ore in sight," and expert estimates as to "probable ore" and "possible ore," are in universal use, when such mines are bought or sold.

Such a valuation was admitted to be feasible, and was required by the Government, under the Federal Corporation Excise.

This company made a valuation, such as was required. It is not material whether this valuation was absolutely accurate.

The *reasonableness* of the depreciation claimed, in any particular case, is to be determined by the evidence.

But *reasonable depreciation* must be allowed in all cases. Otherwise "net income" cannot possibly be arrived at, and *some portion* of the principal becomes taxable, as if it were income.

The vital point here is, that the 5% clause *absolutely precludes the possibility of allowing a reasonable depreciation.* This consequence follows from the adoption of a maximum limit based *on annual output* or *gross receipts,* which can have no possible relation to or bearing upon the fair depreciation of *principal.* Upon the facts here admitted, and in all ordinary cases, the necessary result of such a provision must be that depletion of capital assets cannot be allowed for in a reasonable or adequate manner.

II.

THE INCOME TAX LAW ARBITRARILY, CAPRICIOUSLY AND UNEQUALLY DISCRIMINATES BETWEEN MINING COMPANIES AND ALL OTHER CLASSES OF CORPORATIONS, WITHOUT ANY REASONABLE BASIS FOR DISTINCTION OR CLASSIFICATION.—IT, ACCORDINGLY, DEPRIVES MINING COMPANIES OF THEIR PROPERTY WITHOUT "DUE PROCESS OF LAW," AS GUARANTEED BY THE FIFTH AMENDMENT. — THE SPECIAL CLAUSE LIMITING MINES TO A MAXIMUM ALLOWANCE OF FIVE PER CENT OF THEIR ANNUAL GROSS RECEIPTS OR OUTPUT, FOR DEPLETION OF ORE DEPOSITS, IS UNCONSTITUTIONAL.— OR, IF THE CLAUSE IS NOT SEPARABLE, THE ENTIRE INCOME TAX LAW IS UNCONSTITUTIONAL, AS APPLIED TO MINING COMPANIES.

We now come to the question whether the Income Tax law adopts an improper and unlawful classification, as against mining companies, which discriminates against them capriciously and arbitrarily, resting upon no reasonable basis for distinction.

We assume here that, while Congress has the power to make reasonable and proper classifications, for taxation purposes, it is, nevertheless, subject to the same limitations as the States, with respect to palpably arbitrary classification, following the assumption so often made by this Court.

> *Second Employers' Liability Cases*, 223 U. S. 1, 52, 53.
> *Flint* v. *Stone Tracy Co.*, 220 U. S. 107, 161.
> *United States* v. *Heinze*, 218 U. S. 532, 546.
> *District of Columbia* v. *Brooke*, 214 U. S. 138, 150.

The constitutional limitations upon Congress, for purposes of taxation, are discussed later.

The classification here adopted places mining companies in one class, while all other classes of corporations are put into a distinct class, with totally different privileges, and taxed

under a less onerous rule for valuation, and, in effect, at a different rate.

The same distinction is made between individual owners of mines, including similar natural deposits, and individuals not owning mines.

The professed purpose of the Act is to ascertain and tax the " entire net income arising or accruing from all sources " [Sub-Section A, Subdivision 1; Sub-Section G (*a*)].

In the case of all corporations, except mines [Sub-Section G (*b*)], such " net income " is ascertained by deducting from the " gross amount of the income " of such corporations:

(1) All the ordinary and necessary expenses of maintenance and operation;

(2) "All *losses* actually sustained within the year and not compensated by insurance or otherwise, including a *reasonable allowance for depreciation by use, wear and tear* of property, if any."

All corporations are treated equally up to this point. Then follows the objectionable clause, classifying mines: " and [including], in the case of mines, a *reasonable allowance* for *depletion* of ores and all other natural deposits, *not to exceed 5 per centum of the gross value* at the mine of the *output* for the year for which the computation is made."

Real Effect of Act, as Applied to Mines. — " Reasonable Allowance " for All Losses, Depreciation and Depletion Allowed to All Other Classes of Corporations. — An Unreasonable and Totally Inadequate Allowance to Mines.

While, upon the face of the Act, " reasonable allowance," for *all* losses, and depreciation, is granted to *all* other corporations, the introduction of the maximum provision, as to mines, in substance and effect, converts what is professedly a " reasonable allowance " into an arbitrary, unreasonable, capricious, inadequate, unequal and oppres-

sive allowance, which has no possible bearing on the ascertainment of a fair depreciation, depletion or loss, and bears no reasonable or just relation to the object of the Act, namely, the ascertainment and taxation of the actual, fair " net income."

In other words, this maximum provision means, when its real effect is considered, that all other classes of corporations may deduct a " reasonable allowance " for losses and depreciation, while mines may *not* deduct a *reasonable allowance*, for losses arising from depletion of their capital assets, but are limited to a totally inadequate and *unreasonable* allowance.

The declared purpose of the Act, to allow a " reasonable allowance " to mines for depletion of their ores, becomes a mere delusion and counterfeit show of fairness, if the maximum provision, in its usual or necessary operation and effect, absolutely precludes a " reasonable allowance," by limiting mines to wholly inadequate allowances.

Real Effect of Five Per Cent Clause, as Applied to This Mining Company.

The real effect of this provision is fully set forth in the facts of this case, as admitted by the demurrer (Rec. 4–6).

The real losses and depreciation of this company, arising from depletion of ore deposits, amount to $700,000 per annum (Rec. 4, where, by a mistake the amount is stated to be $750,000. It should be $700,000, or 3½ cents per pound, as the unit value, on the average annual production of 20,000,000 pounds).

Under this special clause, the company is strictly limited to a maximum deduction, for such losses, amounting to $150,000, i. e., 5% of its annual gross receipts or output, amounting to $3,000,000 (Rec. 5).

This company is allowed for approximately one fifth of

its actual losses. — All other classes of corporations may deduct their entire losses and depreciation.

This company is arbitrarily limited to deducting approximately one fifth of its actual losses which arise through depletion of ore deposits.

All other classes of corporations are allowed to deduct their full actual *losses*, including a "reasonable allowance for depreciation."

If this company is allowed to deduct only *one fifth* of a proper and reasonable allowance, which would represent its actual losses by depletion, this is tantamount to saying that it is taxed upon what ought fairly and reasonably to have been deducted or allowed, but is not allowed.

It is, accordingly, taxed for $550,000 beyond what is allowed.

In other words, as compared with *all* other classes of corporations, showing more or less similar losses, whether by depreciation or depletion, this mining company is prohibited from deducting the remainder, or four fifths of its actual losses.

All other classes of corporations are allowed to deduct nearly *five times* as much, or their *entire* loss. This is precisely equivalent to stating that mines are taxed for *four fifths* of their total losses, because not allowed to deduct them, while all other classes of corporations are taxed *absolutely nothing* upon that part of their gross receipts which represents losses or depreciation.

Facts Typical of All Mines.

The facts shown in this record are typical of all copper mines, and, in general, of all other kinds of mines and natural deposits. Indeed, as to copper mines, it would be difficult, if not impossible, to show a case where 5% of the annual gross receipts would represent the full actual losses, by way of depletion. Probably no case can be found where the

depletion of a copper mine is less than the 5% maximum. Almost invariably it must far exceed the maximum, from the very nature of a provision based on annual output.

This Company Taxable on Approximately Twice Its Real Income.

As to the results of the Income Tax, as applied to this company, the record shows that its actual, fair, taxable "net income," after deducting its *whole actual* losses, by way of depletion and depreciation, amounts approximately to $600,000, whereas, under the 5% clause, it is held taxable on $1,150,000 (Rec. 5).

Same Result as if Law Taxed Mines at Two Per Cent Rate and Other Classes of Corporations at One Per Cent.

This company is held taxable on approximately *twice* the amount of its actual "net income."

This is precisely equivalent to a law providing that mines shall be taxed at the rate of 2% and all other classes of corporations at the rate of 1% named for them in the Act.

Natural or Necessary Effect of Such a Provision on All Mines, Not Limiting Argument to Facts of This Particular Case.

We might confidently rest on the facts stated in the record, and argue the question, as applied to this particular company.

But we are content to treat the matter on a broader basis, taking into consideration the natural or *necessary* effect and operation of such provision, when applied to mines and natural deposits, in general.

What is the normal result of a provision like this, basing losses, by depletion, on a fixed percentage of the annual *gross receipts* or "output"?

All other corporations are allowed by the Act, if not

also required by the inherent necessities of a tax upon " net income," to base their losses and depreciation on their total *capital* assets, so far as they waste or depreciate, or are subject to loss.

Five Per Cent Depreciation on Entire Plant or Principal Ordinarily Considered a Fair Rate.

It is common knowledge that 5%, based on the total value of the *plant* or *capital*, is regarded as a reasonable rate of depreciation for a manufacturing plant. This is not an unusual standard, and is frequently adopted, even by tax officials.

A manufacturing company, the assets of which consist chiefly of patent rights expiring in seventeen years, finds its assets depreciating at the annual rate of one seventeenth of its total *principal* or *capital*.

Mining Companies Limited to Five Per Cent of Annual Gross Receipts.

A mining company, under this provision, is strictly limited to deducting a maximum of 5%, based solely on its *annual gross receipts* or " output," and not on its *capital*, as is the case with *all* other classes of corporations, and *all* individuals, except mine owners.

Taking a mine with a life of forty years, like the case at bar, one fortieth of its ore deposits is removed each year and sold, representing its *annual gross receipts*.

A percentage based on annual gross receipts can bear no possible relation to the ascertainment of losses, depletion or net income.

The artificial and arbitrary character of this 5% clause is made even more manifest when it is considered that it is not even based upon " gross income," i. e., gross receipts, less operating expenses. It might equally have been placed

at 1% or 25%. The latter percentage would be necessary, in order to represent the actual fair depletion.

It might be urged that "*gross income*" might have some possible bearing upon "net income." But how can the amount of annual *output* or *gross receipts*, or a percentage thereof, legitimately tend to the ascertainment of the actual "net income" of the corporation?

As the gross annual output constitutes a definite proportion of the total ore deposits, in the case of mines having a reasonably ascertainable length of life, the 5% clause is simply a roundabout way of declaring that a fixed maximum percentage of the total capital assets is deductible each year, to represent losses caused by depletion, regardless of the actual conditions which may obtain in any special mining industry, or in the case of any particular mine.

And this is true, whatever may be the proportions of capital and income which are represented by the annual gross output.

Such a provision here grants an allowance based on 1/800 of the total ore deposits, and equivalent to 1/186 of their net capital value as unmined ore deposits, in place.

This company, having a forty-year life, is entitled to deduct, for losses by depletion, a maximum of 5% of the value of its annual *gross output*, or of one twentieth of one fortieth of its total ore deposits, or of one eight hundredth of its total ore deposits.

This means that $150,000 may be deducted annually or one eight hundredth of the gross value, when mined, of the entire ore deposits ($120,000,000); one three hundred and seventy-third of the net value, when mined ($56,000,000); and one one hundred and eighty-sixth of the capital value of the unmined ore in place ($28,000,000).

A manufacturing plant, at the ordinary 5% rate of depreciation, is entitled to deduct yearly *one twentieth* of the value of its entire *capital*, represented by its plant.

This comparison indicates that this company, solely because its capital is invested in a mine, is entitled to a deduction for losses, by way of depletion, amounting to only one-ninth part of what is accorded to manufacturing corporations, for their losses or depreciation arising in slightly different ways, like wear, tear, use and obsolescence. The assets of certain other classes of corporations deteriorate in precisely the same way, as, for example, companies investing in patent rights, timber lands and the like.

Mines Discriminated Against.—This Company may Deduct only One Ninth of What would Ordinarily be Allowed to a Manufacturing Plant.

Accordingly, mines are discriminated against to the above extent. From this point of view, they are taxed at a rate nine times as high as a manufacturing corporation under the conditions assumed (see Rec. 6).

Exact Extent of Discrimination is Immaterial. — It is Sufficient, if any Palpably Arbitrary Discrimination is Shown.

The figures cited illustrate the gross discrimination created by the 5% clause.

But the exact extent of the discrimination is not important here. It is sufficient if we show any substantial discrimination made arbitrarily and without reasonable basis for distinction.

The natural and necessary effect of such a provision, when we are "looking through forms and reaching the substance of the thing" (*Flint* v. *Stone Tracy Co.*, supra), is not only to discriminate arbitrarily and unequally, but also to award to mines a wholly inadequate and *unreasonable allowance*, although the declared purpose of the Act is to

award, even to mines, a " reasonable allowance " for depletion. The maximum feature absolutely precludes an adequate allowance to this company, as well as in the case of practically all other mines.

A Tax cannot be an " Income Tax," unless Proper Allowance is Made for Losses and Depreciation.

It seems to be thoroughly sound that a tax cannot fairly come within the definition of an " Income Tax," as used in the Sixteenth Amendment, unless it reaches " net income," and nothing else, by making proper deduction for all reasonable losses, depreciation and depletion, however they may arise.

Passing by this contention, which is not essential to our case, we come to the real question presented by the record, upon this branch of the case.

Real Question is, Whether this law, in its effect on mines, is palpably arbitrary classification, resting on no reasonable basis for distinction and bearing no just or proper relation to the object of the Act, namely, the ascertainment and taxation of " net income."

Is a taxing law like this, which taxes mines at a rate nine times, or even twice as much as other classes of corporations, palpably arbitrary classification which rests upon no reasonable basis for distinction, and bears no just or proper relation to the object sought by the Act, namely, the ascertainment and taxation of " net income "?

Or, more exactly stated with reference to losses by depreciation or depletion, is a taxing law of this character constitutional, which taxes mines on four fifths of the amount properly allowable for reasonable losses, by way of depletion, while it taxes *all* other classes of corporations *absolutely no part* of such amount, but allows them to deduct the *whole*

of their fair losses and depreciation, however incurred, whether by depletion of capital assets or otherwise?

If Palpably Arbitrary Classification, This Law, as Applied to Mines, is Unconstitutional, because It Violates "Due Process of Law," as Guaranteed by the Fifth Amendment.

If the Income Tax, as applied to mining companies, creates palpably arbitrary classification, without any reasonable basis for distinction, it deprives them of their property without "due process of law," and is unconstitutional, under the Fifth Amendment. Or, in any event, the 5% clause is void, and, as it is separable, the rest of the Act may be allowed to stand.

The distinction between mining companies and other classes of corporations, for purposes of direct taxation, we submit, would afford no reasonable basis for classification, but would be regarded as palpably arbitrary and unequal, under the "equal protection of the laws" and "due process of law" clauses in the Fourteenth Amendment.—If so, the Act is equally unconstitutional, under the "due process" clause of the Fifth Amendment.

It is true that Congress is no more limited in the scope of its powers of taxation than are the States, under the Fourteenth Amendment.

It is apparent, however, that Congress is limited, to some extent, in such powers. It is, indeed, subject to substantially the same limitations as the States with respect to palpably arbitrary and unequal taxation.

Congress has the Same Power as the States, to Classify, for Purposes of Taxation.

Like the states, Congress clearly has power to make all reasonable classifications which do not result in palpably

arbitrary and unequal taxation, resting upon no reasonable basis for distinction.

It must, however, constantly be borne in mind that here we are dealing with a *direct* tax on "net income," and not with an *excise*, such as the decisions of this Court have frequently dealt with.

Obviously Unlawful Classifications, which may be Suggested.

It may be suggested that a direct "income tax," though expressly authorized by the Sixteenth Amendment, could hardly be sustained, if one rate were imposed on the negroes and a distinct rate on the white population, or if physicians were subjected to one rate and lawyers to a higher rate, or if one rate should apply to citizens of Georgia and a higher rate to citizens of New York.

It might equally be unconstitutional to tax the income of individuals (except so far as gradated according to wealth) at one rate and corporations at a higher rate, or if individuals should be taxed on "net income" and corporations on "gross income," or if individuals should have their taxable income determined through an allowance for depreciation and corporations should be forbidden the like privilege. As shown above, the real operation and effect of the 5% clause is, to tax individuals and corporations, in general, at the 1% rate on their "net income," and to tax mining companies at twice that rate, or more.

Greater Latitude for Classification under Excises than in Direct Taxation, as here.

Excises undoubtedly afford a wider latitude for legislative discretion than can be exercised under the power of direct taxation on incomes and property.

Settled Rules as to Classification, under the Fourteenth Amendment, particularly as to Excises.

Classification, for purposes of taxation, must rest on some "reasonable and sufficient basis of distinction."

Ohio Tax Cases, 232 U. S. 576, 590.

Brown-Forman Co. v. *Kentucky*, 217 U. S. 563, 572.

Lindsey v. *Natural Carbonic Gas Co.*, 220 U. S. 61, 79.

Toyota v. *Hawaii*, 226 U. S. 184, 187.

Magoun v. *Illinois Trust & Savings Bank*, 170 U. S. 283, 293.

Bradley v. *Richmond*, 227 U. S. 477, 484.

Southwestern Oil Co. v. *Texas*, 217 U. S. 114, 121.

Schmidinger v. *Chicago*, 226 U. S. 578.

"While reasonable classification is permitted, without doing violence to the equal protection of the laws, such classification must be based upon some *real and substantial* distinction, *bearing a reasonable and just relation* to the things in respect to which such classification is imposed; and classification cannot be arbitrarily made, without any substantial basis."

Southern Railway Co. v. *Greene*, 216 U. S. 400, 417.

German Alliance Insurance Co. v. *Hale*, 219 U. S. 307, 318.

Kidd, Dater Co. v. *Musselman Grocer Co.*, 217 U. S. 461, 473.

Quong Wing v. *Kirkendall*, 223 U. S. 59, 64, 65.

Connolly v. *Union Sewer Pipe Co.*, 184 U. S. 540, 559.

"But arbitrary selection can never be justified by calling it classification."

Gulf, Colorado & Santa Fé R'y v. *Ellis*, 165 U. S. 150, 157.

Subject to these qualifications, undoubtedly the legislature has a wide discretion, especially in taxation, which should not be abridged by the Courts.

> "In levying excise taxes, the most ample authority has been recognized from the beginning to select some and omit other possible subjects of taxation, to select one calling and omit another, to tax one class of property and to forbear to tax another."
>
> *Flint* v. *Stone Tracy Co.*, 220 U. S. 107, 158, 159, 160.

> "The provision in the Fourteenth Amendment, that no State shall deny to any person within its jurisdiction the equal protection of the laws, was not intended to prevent a State from adjusting its system of taxation in all proper and reasonable ways. It may, if it chooses, exempt certain classes of property from any taxation at all, such as churches, libraries and the property of charitable institutions.
>
> "It may impose different specific taxes upon different trades and professions, and may vary the rate of excise upon various products; it may tax real estate, and personal property in a different manner; it may tax visible property only, and not tax securities for payment of money. It may allow deductions for indebtedness, or not allow them.
>
> "All such regulations, and those of like character, so long as they proceed within *reasonable limits* and *general usage*, are within the discretion of the State legislature, or the people of the State in framing their constitution. But clear and hostile discriminations against particular persons and classes, especially such as are of an *unusual character, unknown to the practice* of our governments, might be obnoxious to the constitutional prohibition.
>
> "We think that we are safe in saying, that the Fourteenth Amendment was not intended to compel the State to adopt an iron rule of equal taxation."
>
> Mr. Justice Bradley, *Bell's Gap R. R. Co.* v. *Pennsylvania*, 134 U. S. 232, 237.
>
> *Southwestern Oil Co.* v. *Texas*, 217 U. S. 114, 121, 127.

Beers v. *Glynn*, 211 U. S. 477.
Hatch v. *Reardon*, 204 U. S. 152.
Armour Packing Co. v. *Lacy*, 200 U. S. 226.
Savannah Thunderbolt & C. Railway v. *Savannah*, 198 U. S. 392.
Cook v. *Marshall County*, 196 U. S. 261.
Home Insurance Co. v. *New York*, 134 U. S. 594.
American Sugar Refining Co. v. *Louisiana*, 179 U. S. 89.

It has never been said, however, that a State may directly tax the real estate of A at one rate, and of B at a higher rate, or the income of lawyers and physicians at different rates, or the property of a cotton mill at 1%, a woolen mill at 2%, a dry goods store at 3%, a shoe factory at 4% and a copper sales company at 5%, etc.

A classification is unconstitutional, if "there is no fair reason for the law that would not require, with equal force, its extension to others whom it leaves untouched."

Barrett v. *Indiana*, 229 U. S. 26, 29, 30.
Watson v. *Maryland*, 218 U. S. 173, 179.
Williams v. *Arkansas*, 217 U. S. 79, 90.
Missouri, Kansas & Texas R'y Co. v. *May*, 194 U. S. 267, 269.
International Harvester Co. v. *Missouri*, 234 U. S. 199, 213.

"An *arbitrary* classification, for purposes of taxation, *would meet neither the requirement of due process*, nor that of the equal protection of the law."

A classification does not offend, because not made "with mathematical nicety or because, in practice, it results in some inequality."

Lindsey v. *Natural Carbonic Gas Co.*, 220 U. S. 61, 78.

Graduated inheritance taxes are based on reasonable classification.

Keeney v. *New York*, 222 U. S. 525.

Magoun v. *Illinois Trust & Savings Bank*, 170 U. S. 283, 293.

" It is competent for a legislature to determine upon what differences a distinction may be made, for the purpose of statutory classification, between objects otherwise having resemblances. Such power, of course, cannot be arbitrarily exercised. The distinction must have reasonable basis."

Mr. Justice McKenna, *International Harvester Co.* v. *Missouri*, 234 U. S. 199, 214, 215.

Clark v. *Kansas City*, 176 U. S. 114.

Gundling v. *Chicago*, 177 U. S. 183.

Petit v. *Minnesota*, 177 U. S. 164.

Williams v. *Fears*, 179 U. S. 270.

Griffith v. *Connecticut*, 218 U. S. 563.

Chicago, R. I. & Pac. R'y Co. v. *Arkansas*, 219 U. S. 453, 466.

Fifth Ave. Coach Co. v. *New York*, 221 U. S. 467.

Murphy v. *California*, 225 U. S. 623.

Rosenthal v. *New York*, 226 U. S. 260, 269, 270.

Denver v. *New York Trust Co.*, 229 U. S. 123, 143.

Patsone v. *Pennsylvania*, 232 U. S. 138, 144.

Missouri, Kansas & Texas R'y v. *Cade*, 233 U. S. 642.

Keokee Coke Co. v. *Taylor*, 234 U. S. 224.

Assuming, however, the adoption of a proper classification, upon a reasonable basis, all within the class selected and subject to like conditions must be treated alike.

Chicago Dock Co. v. *Fraley*, 228 U. S. 680, 681.

Southwestern Oil Co. v. *Texas*, 217 U. S. 114, 121, 127.

Selover, Bates & Co. v. *Walsh*, 226 U. S. 112.

" The equal protection of the laws is a pledge of the protection of equal laws " to all under like circumstances.

> *German Alliance Ins. Co.* v. *Hale,* 219 U. S. 307, 318.
> *Yick Wo* v. *Hopkins,* 118 U. S. 356, 367.
> *Barbier* v. *Connolly,* 113 U. S. 27.
> *Soon Hing* v. *Crowley,* 113 U. S. 703.

Discriminatory Features of the Act, as Applied to Mines.

SUMMARY OF REASONS WHY IT IS PALPABLY ARBITRARY.

The discriminatory features of this Act, as applied to mines, which result in improper and unlawful classification, resting on no reasonable basis for distinction, may be summarized thus:

(1) The Act, in its primary classification, places individuals in one class and corporations in another. Under the general rule, all corporations, in the same class and subject to similar conditions, must be treated alike. Mining companies are, however, subjected to arbitrary discrimination as to depreciation. Corporations, in general, depreciate and deteriorate under substantially the same conditions as mines. They are allowed to deduct their *entire* losses and depreciation. Mining companies are limited to 5% of their annual gross receipts.

(2) By a sub-classification founded on no reasonable basis, the 5% clause places mining companies in one class and *all* other corporations in another class.

Its real or inevitable effect is to tax mines more onerously, and, indeed, at a higher rate than any other class of corporations. The exact extent of the discrimination is wholly immaterial. There is " no fair reason for the law that would not require, with equal force, its extension to others whom it leaves untouched."

(3) For purposes of valuation, in order to ascertain and

tax " net income," the losses and depreciation of mines are based on their *annual gross receipts* or " output," while, for all other classes of corporations, the rule of valuation is to base their losses and depreciation on the value of the *entire principal* or *capital* invested in plant or other deteriorating assets.

(4) All other classes of corporations are granted a " reasonable allowance," for losses, by depletion, while mining companies are strictly limited to a basis which affords only an inadequate and *unreasonable allowance* for such losses.

(5) If the purpose of the Act was to select and set apart those corporations which are engaged in a business where the product represents largely wastage of capital assets, the Act does not apply equally to those in the same class, for it does not extend to companies investing in patent rights, timber lands, and other wasting properties.

(6) The classification has no " just and reasonable relation " to the object of the Act, namely, the ascertainment and taxation of " net income," for the following reasons:

(*a*) It cannot be argued that the actual " net income " of mining companies, or their fair losses and depreciation, are impossible to ascertain with reasonable accuracy, and, therefore, they must be classed by themselves, for their valuation, while admittedly difficult, is no more so than in the case of many other corporations.

The valuation of railroads and gas plants may be referred to as presenting equally difficult problems.

(*b*) The deduction of a percentage of annual *gross receipts* or *output* has not the remotest bearing on or relation to the ascertainment of what is actually " net income " or profit.

" Gross income " has some bearing on the question as to size of the business or the wealth of the owner, for the purposes of an *excise* tax measured by "gross income," as in *Flint* v. *Stone Tracy Co.* But how can a fixed percentage of *gross receipts* assist in determining the actual losses, depreciation and " net income " of any business property?

By what "rule of reason" will a 5% deduction from *gross receipts* determine the "net income" rather than any other percentage?

The Act, with equal pertinence, might have allowed the deduction of any arbitrarily fixed percentage, based on the amount of cash in the bank, the total wages paid, the number of hands employed or the number of feet to which the mine shaft had been sunk, all these being inconsequential differences, having no determinative bearing upon the actual "net income" of a mining company.

(*c*) One natural deposit, like an oil or gas well, may be extracted without any substantial cost of labor or equipment. The product of another, like a copper mine, may result chiefly from labor processes, involving large expense, and akin to manufacturing, where there is ordinarily a slight margin of profit above cost. "Gross receipts," in the one case, might represent an approximation to "net income," while, in the other, they would be far removed from it.

(*d*) The product of one may be wholly the result of luck or accident, like the finding of precious stones in a diamond field, while the product and extent of another, like an iron mine, may be capable of fairly exact measurement, while still unmined.

(*e*) One may be exhausted in one year, another in one hundred years.

(*f*) One, when extracted, may represent capital chiefly; another largely income.

(*g*) The "net income" of one may be largely dependent on frequent changes in market price of the product, like copper.

Another may have relatively fixed and stable prices, like coal.

(*h*) One may be dependent, for its net profits, on skill in management, while another, like an oil gusher, may wholly lack this feature.

Yet all classes of mines and natural deposits are judged

by the same crude test of depreciation and income, and compelled arbitrarily to render to the Government a tax on all their gross receipts, aside from operating expenses and 5% of the " gross value at the mine of the output " for the year.

The difference of conditions, in each individual case, illustrates the folly of asserting that, in all cases, exactly 5% of the " gross receipts," or less, must represent the fair losses by depletion of capital assets, and that the balance remaining must represent the actual " net income " of a mining company.

Differences in the conditions applicable to separate classes of natural products show also that, if the classification is proper, the 5% clause necessarily results in inequality in the same class, for the different mines cannot be treated alike and according to their special conditions, under such a provision.

(7) Mines are limited to deductions based on the gross value of their output " at the mine."

Other classes of corporations have their valuation determined by " market value," and not by prices determined at the mouth of the mine, where, ordinarily, such a thing as " market value " does not exist.

(8) For purposes of ascertainment and taxation of " net income," the professed object of the Act, one rule of valuation, namely, gross income, less operating expenses and a reasonable percentage on *principal*, to represent losses, by including depreciation, is prescribed for all individuals and all corporations, except mining companies. On the other hand, a totally different rule of valuation, namely, gross income, less operating expenses and a fixed maximum percentage on *gross receipts* or *gross output*, is adopted for mining companies and individual owners of mines.

(9) Because " clear and hostile discriminations against particular persons and classes, especially such as are of an *unusual* character, *unknown* to the practice of our Govern-

ments" are obnoxious to the constitutional prohibitions (*Bell's Gap R. R. Co.* v. *Pennsylvania*, 134 U. S. 232, 237).

This mode of ascertaining depreciation and net income is wholly new. It is directly opposed to the fair method adopted in the preceding system, imposing the Federal Corporation Excise.

Decisions of Controlling Importance Here, and Holding State Laws to be Palpably Arbitrary Classification and, therefore, in Violation of "Equal Protection of the Laws" and "Due Process of Law."

We submit that there is no decision of this Court which goes to the extent of upholding such palpably arbitrary selection, discrimination and classification as appears in the 5% clause.

On the contrary, classifications have been held to be unconstitutional, which were no more arbitrary and unequal than the present classification.

Gulf, Colorado & Santa Fé R'y v. Ellis (165 U. S. 150).

In this case, the Texas statute was held to be unconstitutional, under the "due process" and "equal protection" clauses, which provided that any person having a claim not exceeding fifty dollars against a railroad company, for stock killed or injured, damages, overcharges, etc., might present it for payment, by filing it with a station agent, and, if not paid within thirty days, and the claimant should finally establish his claim in court, as filed, in addition to costs, he should be entitled to recover from the railroad a reasonable attorney's fee, not exceeding ten dollars.

The ground for the decision was that railroad companies cannot be singled out from all other classes of corporations and individuals and compelled to pay attorney's fees to

successful plaintiffs, while the plaintiffs, if unsuccessful, are not subjected to payment of such fees.

Mr. Justice Brewer there says:

> "They [railroads] do not enter the courts upon equal terms. They must pay attorney's fees, if wrong; they do not recover any, if right; while their adversaries recover, if right, and pay nothing, if wrong. In the suits, therefore, to which they are parties, they are discriminated against, and are not treated as others.
>
> "They do not stand equal before the law. They do not receive its equal protection" (p. 153). . . .
>
> "It is well settled that corporations are persons within the provisions of the Fourteenth Amendment" (p. 154). . . .

The learned justice proceeded to state that, although the Fourteenth Amendment, as a general proposition, does not withhold the power of classification from the States,—

> "Yet it is equally true that such classification cannot be made arbitrarily. The States may not say that all white men shall be subjected to the payment of the attorney's fees of parties successfully suing them, and all black men not. It may not say that all men beyond a certain age shall be alone thus subjected, or all men possessed of a certain wealth.
>
> "These are distinctions which do not furnish any proper basis for the attempted classification.
>
> "That must always rest upon some difference which bears a reasonable and just relation to the act in respect to which the classification is proposed, and can never be made arbitrarily and without any such basis" (p. 155).

Singling Out of Railroads, under Gulf, Colorado Case, No More Arbitrary than Selection of Mining Companies Here.

The singling out of railroads from all other classes of corporations, with respect to a special ten dollar liability for attorney's fees, would seem to be no more arbitrary than the singling out and selection of mining companies, as the

subject for a special tax provision or mode of valuation, which has the actual effect of taxing them at a rate twice as great as other classes of corporations, and possibly much more.

The result of this clause is, that a tax is exacted upon a valuation of $1,150,000 of income, instead of the proper actual " net income " of approximately $600,000, as it would be determined to be, if the rules applicable to all other classes of corporations were applied to this mining company, instead of the arbitrary maximum allowance of 5% on *gross receipts* or *gross output*.

The classification here bears no " reasonable and just relation " to the object of the Income Tax Act, the ascertainment and taxation of actual " net income."

The *Gulf, Colorado* case holds that the classification adopted must bear some " reasonable and just relation " to the real purposes of the legislation.

Tested by this principle, this Act must fall, as applied to mines, for (unless it be merely an arbitrary attempt to extract an extortionate tax from mining companies on account of their supposed wealth, an intention which cannot properly be ascribed to Congress), the 5% clause cannot be supported, as tending, in any reasonable way, to the ascertainment and determination of actual " net income " of mining companies, the product of which, like many other corporations, represents a mixture of income and of a wasting or deteriorating capital. The clause does not bear any " reasonable and just relation " to the purposes of Congress, the ascertainment and taxation of the fair " net income."

Arguments Rejected in Gulf, Colorado Case, as Bearing No Reasonable and Just Relation to the Object of the Legislation.

Various reasons were there suggested why railroads might be singled out for the purposes of this liability for attorney's fees, but they were all rejected, as they should be here,

because the classification adopted bore no " reasonable and just relation " to the purposes of the act.

It was there argued that " this penalty is cast only upon corporations, that to them special privileges are granted, and therefore upon them special burdens may be imposed."

The Court replied to this suggestion:

> " It is a sufficient answer to say that the penalty is not imposed upon *all* corporations. The burden does not go with the privilege. Only railroads, of all corporations, are selected to bear this penalty. The rule of equality is ignored " (p. 157). . . .
>
> " So, the classification is not based on any idea of special privileges by way of incorporation, nor of special privileges given thereby for purposes of private gain, nor even of such privileges granted for the discharge of one general class of public duties."

The Court, while admitting that railroads may be classified for some purposes, because of the peculiar hazards of their business, holds that this consideration has no pertinent bearing upon the imposition of attorney's fees (p. 158).

The Court further says:

> " Unless the legislature may *arbitrarily select one corporation* or *one class of corporations*, one individual or one class of individuals, and visit a penalty upon them which is not imposed upon others guilty of like delinquency, this statute cannot be sustained " (p. 159).

In conclusion, the Court says:

> " It is apparent that the mere fact of classification is not sufficient to relieve a statute from the reach of the equality clause of the Fourteenth Amendment, and that in all cases it must appear, not only that a classification has been made, but also that it is one based upon some reasonable ground,—some difference which bears a just and proper relation to the attempted classification—and is not a mere arbitrary selection " (p. 165).

Missouri, Kansas & Texas R'y v. **Cade** (**233** U. S. **642**).

The proper limitations of these doctrines have recently been considered, where the Court fully recognizes the soundness of the above decision, but points out that the somewhat similar Texas statute (which is upheld as constitutional) "differs in essential features," which allows small attorney's fees to plaintiffs, on claims not exceeding two hundred dollars, against *all* persons and corporations, but not singling out railroads.

Mr. Justice Pitney says:

> "There is here no classification of debtors; the act bears equally against individuals and against corporations of any class doing business in the State. It applies only to certain kinds of claims; but these cover a wide range, and do not appear to have been grouped together for the purpose of *bearing against any class or classes of citizens or corporations.* Unless something of this sort did appear we should not be justified in holding the act to be repugnant to the Fourteenth Amendment" (p. 649).

Cotting v. **Kansas City Stockyards Co.** (**183** U. S. **79**).

In this case the Kansas Statute was held to deny "equal protection of the laws" which defined public stockyards as those which, on the average, received each day one hundred head of cattle or three hundred head of hogs or sheep, and which regulated the duties and charges of such yards, because it appeared that the law affected only the Kansas City Stockyards Company, and not any other corporations engaged in like business in Kansas.

Mr. Justice Brewer there says:

> "If once the door is opened to the affirmance of the proposition, that a State may regulate one who does much business, while not regulating another who does

the same, but less business, then all significance in the guarantee of the equal protection of the laws is lost. . . .

"This statute is not simply legislation which, in its indirect result, affects different individuals or corporations differently . . . but is a positive and direct discrimination, between persons engaged in the same class of business and based simply upon the quantity of business which each may do. If such legislation does not deny the equal protection of the laws, we are unable to perceive what legislation would" (p. 112).

Connolly v. Union Sewer Pipe Co. (184 U. S. 540).

This case held that the Illinois Trust Act denied "equal protection of the laws" and was unconstitutional, which forbade combinations of capital, skill, etc., because it exempted combinations of owners of "agricultural products or live stock, while in the hands of the producer or raiser."

This exemption was held to created unlawful classification based on no reasonable distinction.

Mr. Justice Harlan says:

"In prescribing regulations for the conduct of trade, it cannot divide those engaged in trade into classes and make criminals of one class, if they do certain forbidden things, while allowing another and favored class engaged in the same domestic trade to do the same things with impunity.

"It is quite a different thing for the State, under its general police power, to enter the domain of trade or commerce, and discriminate against some, by declaring that particular classes within its jurisdiction shall be exempt from the operation of a general statute making it criminal to do certain things connected with domestic trade or commerce. Such a statute is not a legitimate exertion of the power of classification, rests upon no reasonable basis, is purely arbitrary, and plainly denies the equal protection of the laws to those against whom it discriminates.

"We must not be understood, by what has been said, as conceding that the question of a denial of the equal

protection of the laws can never arise under the taxing statutes of a State. On the contrary, the power to tax is so far limited that it cannot be used to impair or destroy rights that are given or secured by the supreme law of the land. . . .

"We conclude this part of the discussion by saying that, to declare that some of the class engaged in domestic trade or commerce shall be deemed criminals, if they violate the regulations prescribed by the State, for the purpose of protecting the public against illegal combinations formed to destroy competition and to control prices, and that others of the same class shall not be bound to regard those regulations, but may combine their capital, skill or acts to destroy competition and to control prices for their special benefit, is so manifestly a denial of the equal protection of the laws that further or extended argument to establish that position would seem to be unnecessary" (pp. 563, 564).

Southern R. R. Company v. Greene (216 U. S. 400).

In this case we have a striking illustration of unlawful arbitrary classification, resting on no reasonable basis for distinction.

It was held that a statute of Alabama, requiring a foreign corporation to pay an additional special excise, when it had already entered the State, under authority of the State, and had paid the excise then required, and property taxes, under the existing system of taxation, and had acquired a considerable amount of permanent and valuable property in the State, denied to such a corporation the equal protection of the laws, because domestic corporations, owning the same character of property and carrying on the same kind of business, were not also required to pay a similar tax.

In the course of the opinion, Mr. Justice Day says:

"We, therefore, reach the conclusion that the corporation plaintiff, under the conditions which we have de-

tailed, is, within the meaning of the Fourteenth Amendment, a person within the jurisdiction of the State of Alabama, and entitled to be protected against any statute of the State which deprives it of the equal protection of the laws.

" It remains to consider the argument made on behalf of the State of Alabama, that the statute is justified, as an exercise of the right of classification of the subjects of taxation, which has been held to be entirely consistent with the equal protection of the laws guaranteed by the Fourteenth Amendment.

" It is argued that the imposition of special taxes upon foreign corporations for the privilege of doing business within the State, is sufficient to justify such different taxation, because the tax imposed is different, in that the one imposed on the domestic corporation is for the privilege of being a corporation, and on the foreign corporation is for the privilege of such corporation to do business within the State.

" While reasonable classification is permitted, without doing violence to the equal protection of the laws, such classification must be based upon some real and substantial distinction, bearing a reasonable and just relation to the things in respect to which such classification is imposed; and classification cannot be arbitrarily made without any substantial basis. Arbitrary selection, it has been said, cannot be justified by calling it classification. . . .

" It is averred in the complaint, and must be taken as admitted, that there are other corporations of a domestic character in Alabama carrying on the railroad business in precisely the same way as the plaintiff. It would be a *fanciful distinction* to say that there is any *real difference* in the burden imposed, because the one is taxed for the *privilege of a foreign corporation to do business* in the State, and the other *for the right to be a corporation.* The fact is that both corporations do the same business in character and kind, and, under the statute in question, a foreign corporation may be taxed many thousands of dollars for the privilege of doing, within the State, exactly the same business as the domestic corporation is permitted to do by a tax upon its privilege, amounting to only a

few hundred dollars. We hold, therefore, that, to tax the foreign corporation for carrying on business, under the circumstances shown, by a different and much more onerous rule than is used in taxing domestic corporations for the same privilege, is a denial of the equal protection of the laws, and, the plaintiff being in position to invoke the protection of the Fourteenth Amendment, that such attempted taxation, under a statute of the State, does violence to the Federal Constitution."

If the distinction is " fanciful " between domestic and foreign corporations, and based on no " real difference " which has any material bearing on the object of the legislation, the distinction is equally " fanciful " between mining and other investments, when the legislation is concerned in each case merely with the ascertainment and taxation of " net income."

If a law selecting a foreign corporation, as a mark for taxation, out of all the corporations doing business in the State, is deemed arbitrary and unwarranted classification, because other corporations are left untaxed simply because they are domestic corporations, although they " do the same business in character and kind," it is difficult to see how mining companies may lawfully be singled out of all corporations, and subjected to a more onerous rate of taxation and burdensome rules for valuation and ascertainment of " net income," and limited to an *unreasonable* and inadequate fixed allowance for losses or depletion, whereas *all* other classes of corporations are granted a " reasonable allowance for losses," including their full depreciation, simply and solely because the former own mines, the product of which is more of a mixture of capital and income than the products of ordinary kinds of corporations.

Here the thing taxed is the same, namely, " net income." The professed rate is the same, 1%.

The subjects of the tax are the same, *all* corporations. The corporations differ only in a slight inconsequential detail, in that one company owns a mine, and another a

manufacturing plant or other form of investment, both, however, being subject to depreciation and depletion, but, perhaps, at different rates of rapidity, a consideration which cannot possibly be regarded as establishing a real distinction which bears any "reasonable and just relation to the things in respect to which such classification is imposed," namely, the ascertainment and taxation of actual "net income."

For the purposes of the Act, a totally new and unheard of mode of valuation is prescribed for mining companies, which is not at the same time imposed on other corporations.

The actual result of such discrimination is that mining companies are subjected to a tax of twice as much as other corporations, at the lowest calculation.

Flint v. Stone Tracy Company (220 U. S. 107).

This case differed wholly from the *Greene* case. The classification was obvious and reasonable. *All* corporations were taxed by the Federal Corporation Excise there involved, while all individuals and partnerships were exempted, although transacting the same kind of business. The business might be the same. But the obvious difference consisted in the fact that corporations were selected, as subjects for the tax, because of the substantial privilege which they exercise, of transacting business in a corporate form.

As there stated by Mr. Justice Day:

> "It could not be said, even if the principles of the Fourteenth Amendment were applicable to the present case, that there is no substantial difference between the carrying on of business by the corporations taxed, and the same business, when conducted by a private firm or individual.
>
> "The thing taxed is not the mere dealing in merchandise, in which the actual transactions may be the same, whether conducted by individuals or corporations, but the tax is laid upon the privileges which exist in conduct-

ing business with the advantages which inhere in the corporate capacity of those taxed, and which are not enjoyed by private firms or individuals. These advantages are obvious" (p. 161).

Principles of the Southern Railway Case Not Weakened by the Flint Decision.

By the *Flint* decision the principles of the *Southern Railway* case are not, in any way, weakened. The decision is not questioned.

As Mr. Justice Day remarks:

> "It is insisted, in some of the briefs assailing the validity of this tax, that these cases have been modified by *Southern Railway Co.* v. *Greene* (216 U. S. 400)." . . .
>
> "In that case the foreign corporation was doing business under the sanction of the State laws no less than the local corporation; it had acquired its property under sanction of those laws; it had paid all direct and indirect taxes levied against it, and there was no practical distinction between it and a state corporation doing the same business in the same way" (p. 161).

Nor is the effect of the *Southern Railway* case modified by the decision in *Baltic Mining Co.* v. *Massachusetts* (231 U. S. 68), where that foreign corporation failed to show that it was on exactly the same plane as domestic corporations engaged in the same business, because it did not, like them, possess a substantial amount of locally taxable property, the Court saying:

> "We do not find in this situation an acquisition of *permanent property*, such as was shown in the *Greene* case" (p. 88).

Smith v. **Texas (233 U. S. 630).**

The above is an important case, as indicating what amounts to arbitrary classification. There the Texas

statute was held to deny "equal protection of the laws" which prohibited any person from acting as a conductor on a railroad train, unless, for two years previously, he had worked as a brakeman or conductor on a freight train, and prescribing no other qualifications, because it was held to result in excluding the whole body of the public from the right to secure such employment, although competent, if they did not possess the prescribed qualifications.

Mr. Justice Lamar there says:

> "This and other cases establish, beyond controversy, that, in the exercise of the police power, the State may prescribe tests and require a license from those who wish to engage in or remain in a private calling affecting the public safety. The liberty of contract is, of course, not unlimited; but there is no reason or authority for the proposition that conditions may be imposed, by statute, which will admit some who are competent and arbitrarily exclude others who are equally competent to labor on terms mutually satisfactory to employer and employé. None of the cases sustain the proposition that, under the power to secure the public safety, a privileged class can be created and be then given a monopoly of the right to work in a special or favored position. Such a statute would shut the door, without a hearing, upon many persons and classes of persons who are competent to serve and would deprive them of the liberty to work in a calling they were qualified to fill, with safety to the public and benefit to themselves (p. 638). . . .
>
> "So that the case distinctly raises the question as to whether a statute, in permitting certain competent men to serve, can lay down a test which absolutely prohibits other competent men from entering the same private employment" (p. 641).

So here the question is, Can a statute lay down a test which "absolutely prohibits" mines from showing their *actual* losses and depreciation and their real "net income," while all others are allowed to show the *real* facts?

All corporations, being in the same class and under substantially the same conditions, must be treated alike, with respect to rules for valuation of "net income." No diversity of conditions, in any material aspect, between mining and other companies, can be shown to exist.

Classification, for purposes of taxation, must treat alike all who are in the same class and under the same conditions. Otherwise the classification is clearly unconstitutional, as offending "equal protection of the laws" and "due process of law," whether under the Fifth or the Fourteenth Amendment.

Here the primary classification is between corporations and individuals.

All corporations under like conditions must be treated alike in all cases, and particularly where direct taxation, like an income tax, is involved.

One rule of valuation, for the ascertainment of "net income," cannot be imposed on one class of corporations, and a more onerous rule on another class, resulting in unequal burdens, unless it can clearly be demonstrated that diversity of conditions warrant or require the ascertainment of "net income" by totally distinct methods.

Here corporations, in general, are taxed by rules fairly designed to ascertain their actual "net income," and to tax that only.

Mining companies are taxed, practically, on "gross receipts," less operating expenses, the 5% allowance being so trifling and immaterial as to be practically negligible.

Assuming the primary classification to be proper, for this company is in no position to raise the question that it is discriminated against by reason of the super-tax on individuals, the question remains whether all corporations may be further classified and divided into —

(1) Mining companies, and

(2) All other classes of corporations.

Unless this sub-classification can be justified, as based on some reason which has a legitimate bearing on the object sought by the legislation, namely, the ascertainment and taxation of "net income," the classification must be deemed palpably arbitrary and unconstitutional, because all corporations, under the same conditions, are not treated alike.

Even in the case of excises, occupation taxes and the like, it is well settled that all within the same class, and subject to like conditions, must be treated alike.

Southwestern Oil Co. v. *Texas*, 217 U. S. 114, 121, 127.

Chicago Dock Co. v. *Fraley*, 228 U. S. 680, 687.

Selover, Bates & Co. v. *Walsh*, 226 U. S. 112, 125, 126.

> "The rule of equality, in respect to the subject, only requires the same means and methods to be applied impartially to *all* the constituents *of each class*, so that the law shall operate equally and uniformly upon all persons in *similar circumstances*."

Kentucky Railroad Tax Cases, 115 U. S. 321, 337.

Home Insurance Co. v. *New York*, 134 U. S. 594, 606.

If this is true as to excises, still more clearly is it sound law, when direct taxes are under consideration.

Unless some sound basis for distinction can be found for the sub-classification which divides corporations into different classes, with distinct privileges and liabilities, and totally different rules for valuation, it follows that *all* corporations, under the same conditions, are not treated alike, and, therefore, the law is unconstitutional.

Mining companies have their income determined by a more onerous rule of valuation.

By common knowledge, as well as the facts stated in the Record, it is apparent that the "net income" of mining companies here is ascertained by a rule of valuation more

onerous than that applied to all other companies, and that, in effect, they are subjected to the payment of a higher rate of taxation than corporations which are fortunate enough to have their investment in a manufacturing plant, rather than a mine.

All other classes of corporations are allowed to deduct their *entire* losses, including a "reasonable allowance" for depreciation and depletion. Mining companies are allowed only to deduct a *portion* of such losses, and, indeed, a small fraction thereof.

They are arbitrarily limited to a fixed maximum deduction, which almost universally results in an unreasonable and totally inadequate allowance for such losses.

All other corporations are taxable on their "net income," after deduction of *all* reasonable losses, however incurred.

Mining companies, in substance and effect, are taxed on their "gross income," after deduction of operating expenses, the 5% deduction being practically negligible in amount.

Clearly, then, *all* corporations are not treated alike, under the operation of the 5% clause applicable only to mines.

Some in the same class are subjected to discriminating rules for valuation of income.

Question arises whether a direct tax on property or income is constitutional which prescribes distinct rules for valuation for different business corporations.

Before coming to the question whether any reasonable basis, having a legitimate bearing on the purposes of the Act, can possibly be suggested which would justify the sub-classification of corporations, the important question directly arises whether a direct tax on property or on incomes is constitutional which prescribes one rule of valuation for one business corporation and a distinct rule for another.

San Bernardino County v. Southern Pacific R. R. 118 U. S. 417.

The importance of this fundamental inquiry is stated in the concurring opinion of Mr. Justice Field in the above case, where the learned justice regrets that the Court did not find it necessary to determine the constitutional question there argued, to the effect that individuals and corporations were subjected to distinct rules of property valuation, in that,

> " In the assessment, upon which the taxes claimed were levied, an unlawful and unjust discrimination was made between the property of the defendant [company] and the property of individuals, to its disadvantage, thus subjecting it to an unequal share of the public burdens, and, to that extent, depriving it of the equal protection of the laws guaranteed by the Fourteenth Amendment of the Constitution. . . .
>
> " It is, therefore, of the greatest interest to them [corporations] whether their property is subject to the same rules of assessment and taxation as like property of natural persons, or whether elements which affect the valuation of property are to be omitted from consideration, when it is owned by them, and considered, when it is owned by natural persons; and thus the valuation of property be made to vary, not according to its condition or use, but according to its ownership. The question is not whether the State may not claim for grants of privileges and franchises a fixed sum per year, or a percentage of earnings of a corporation — that is not controverted — but whether it may prescribe *rules for the valuation* of property for taxation which will vary according as it is held by individuals or by corporations. The question is of transcendent importance, and it will come here and continue to come until it is authoritatively decided in harmony with the great constitutional amendment which insures to every person, whatever his position or association, the equal protection of the laws; and that necessarily implies freedom from the imposition of unequal burdens, under the same conditions (*Barbier* v. *Connolly*, 113 U. S. 27, 31)" (pp. 422, 423).

So here, may Congress " prescribe *rules for the valuation* of property for taxation which will vary according as it is held " by one kind of private business corporation or another?

Conceding that valuations may properly be reached by boards of appraisers, or by distinct methods of valuation, or even by different rules, in the case of railroads or other peculiar classes of *quasi*-public corporations, the fundamental question remains: Under an Act professing to ascertain and tax " net income," can one kind of business corporations be taxed on a valuation of its " net income," to be ascertained by an arbitrarily fixed maximum deduction, which can have no legitimate bearing on the ascertainment of " net income," but is based practically on " gross income," while all other classes of corporations are taxable on their *actual* " net income," after deducting *all* reasonable losses, depreciation and depletion?

Or, according to the real substance and effect of this tax (the 5% deduction being so inadequate as to be practically negligible), can a mining company be taxed on its " gross receipts " (after deducting operating expenses), while *all* other corporations are taxable only on their " net income " ?

The statement of the issue, in this form, would seem to demand the answer that a law thus arbitrarily discriminating against one class of corporations violates " due process of law " under the Fifth Amendment, in that it denies " equal protection of the laws," for " that necessarily implies freedom from the imposition of unequal burdens, under the same conditions " (Mr. Justice Field, *supra*).

This, however, is the real substance and effect of the 5% clause, as the facts in the Record distinctly show, as well as the obvious results of such a provision, as applied to any kind of a mine or natural deposit.

No reasonable basis can be suggested for the 5 per cent clause which " would not require, with equal force, its extension " to all other corporations.

Classification is palpably arbitrary and unconstitutional, if " there is no fair reason for the law that would not require, with equal force, its extension to others whom it leaves untouched."

Barrett v. *Indiana*, 229 U. S. 26, 29, 30.

No sound reason can be suggested why this rule of valuation of mining income should not fairly be extended to all other classes of corporations, if it should apply to mines.

Distinct Rules for Valuation of Income Prescribed for Mining Companies and Other Classes of Corporations.

If the Act establishes one rule of valuation for the ascertainment of the " net income " of mining companies and creates an entirely distinct and much more advantageous rule for *all* other corporations and *all* individuals, except mine owners, surrounding them with every possible safeguard, so that they shall be taxable on nothing but " net income," it necessarily results in class legislation and favoritism, and denies to mining companies the " equal *protection of the laws.*"

The vital distinction from other cases is that here there are distinct rules of valuation prescribed for different classes of private business corporations. These result in a higher rate of taxation. — They do not constitute mere methods of valuation of mining properties, designed to reach the same result, namely, the ascertainment of actual " net income," but are calculated, if not intentionally designed, to reach a different result. — In effect, the law levies a 1% tax on the income of all other corporations, and 2% on mining companies. — All within the same class are not treated alike. — Various cases holding that distinct methods of appraisal or even distinct taxes may be prescribed for railroads and other quasi-public corporations, have no application to a case of obvious discrimination between ordinary business corporations,

based solely on their possession of different kinds of invested assets.

Here the primary classification is between corporations and individuals, the latter being subjected to the super-tax.

All in the class of corporations clearly are not treated alike.

No reasonable basis can be suggested for the sub-classification between mining corporations and other classes of companies.

Unless a fair basis for distinction can be shown, the sub-classification is purely arbitrary, and cannot be allowed to stand.

The law, therefore, falls, as applied to mining companies.

We submit that no case has yet gone to the extent of deciding that, for purposes of direct taxation, one class of ordinary business corporations may be taxed at the rate of 1% and another class at 2%, or that physicians may be taxed at one rate and lawyers at a higher rate.

Nor has any case yet decided that entirely distinct rules of valuation designed to levy, or necessarily imposing separate rates of taxation for different classes of ordinary business corporations, can be supported.

Cases may be referred to, which uphold the valuation of distinct classes by different *methods* of appraisal, or which hold that peculiar property, like that of railroads or other *quasi*-public corporations, may be separately treated because of fundamental differences growing out of "the inherent nature of the property."

But the question is quite different, whether private business corporations may be arbitrarily classified, and different rates of direct taxation imposed, *solely because of* the nature of their investments, whether manufacturing plants, timber lands, patent rights, or, as here, mines. If so, individuals may likewise be classified, and there is no escape from the conclusion that A may be taxed on his real estate at one

rate and B, at a higher rate on his real estate used for slightly different purposes.

Kentucky Railroad Tax Cases, 115 U. S. 321.

This decision merely held that different *methods of valuation* of property, for taxation, might constitutionally be applied to railroads, which were not applied to the real estate or other property of individuals, and that the value of one might properly be determined by a board of railroad commissioners, and that of the other by ordinary tax assessors.

As stated by Mr. Justice Matthews:

> "The different nature and uses of their property justify the discrimination in this respect, which the discretion of the legislature has seen fit to impose" (p. 337). . . .
>
> "The right to classify railroad property, as a separate class, for purposes of taxation, *grows out of the inherent nature of the property*, and the discretion vested by the Constitution of the State in its legislature, and necessarily involves the right, on its part, to devise and carry into effect a distinct scheme, with different tribunals, in the proceeding to value it. If such a scheme is due process of law, the details in which it differs from the mode of valuing other descriptions and classes of property cannot be considered as a denial of the equal protection of the laws" (p. 339).

Michigan Central Railroad v. Powers, 201 U. S. 245.

This case rests upon the same doctrine, applicable to railroads.

Although the language of the Court goes further, the case itself did not really involve distinct *rates* of taxation on different classes of property, because the Michigan statute imposed on railroads the average rate paid by other property subject to *ad valorem* taxes, applying the proceeds to State purposes.

Mr. Justice Brewer rests his statement of the doctrine solely upon the authority of the *Kentucky Railroad Tax Cases* (*supra*):

> "That, so far as the restraints of the Federal Constitution are concerned, it is within the power of a State to separate a particular class of property, subject it to assessment and taxation in a mode and at a rate different from that imposed upon other property, and apply the proceeds to State rather than to local purposes, is not open to question."

See other railroad cases.

Pittsburgh Etc. Railway Co. v. *Backus*, 154 U. S. 421.

Florida Central Etc. R. R. Co. v. *Reynolds*, 183 U. S. 471.

Coulter v. *Louisville & Nashville R. R. Co.*, 196 U. S. 599.

Upon similar principles, it is well settled, as to express, telegraph and sleeping car companies, that their property, in the several States through which their lines run, may be *valued as a unit*, for purposes of taxation, taking into consideration their inherent nature, the uses to which their property is put, and all other elements making up its aggregate fair value, and that a proportion of the whole value may be taxed by the particular State, without violating the Federal Constitution.

Adams Express Co. v. *Ohio*, 165 U. S. 194: 166 U. S. 185.

Western Union Telegraph Co. v. *Taggart*, 163 U. S. 1.

Pullman's Palace Car Co. v. *Pennsylvania*, 141 U. S. 18.

The difference between mere *methods* and *rules* of valuation, is well illustrated by the decisions covering discriminating taxes against National bank shares, at a greater rate than those imposed on other monied capital, in violation of Section 5219 of the Revised Statutes.

It is held that a State law does not contravene the statute, if it merely provides one *method* for taxation of shares of State banks, and a distinct *method* for shares of National banks.

But if different *rules of valuation* are prescribed, whereby all intangible elements of value are taken into account in assessing National bank shares, but only the ordinary elements of property valuation are considered in the taxation of shares of State banks, an unlawful discrimination against National banks is shown, which is void under the statute.

> *San Francisco National Bank* v. *Dodge*, 197 U. S. 70.
>
> *Covington* v. *First National Bank*, 198 U. S. 100.

Ohio Tax Cases, 232 U. S. 576.

This decision merely covers an *excise* based on intrastate gross earnings. Direct property taxation is not involved. The law was confined to " public utilities."

Distinctions between mining and other corporations, for purposes of taxation, are merely fanciful.—No reasonable basis for distinction can be suggested, which bears any "reasonable and just relation " to the object of the Act, namely, the ascertainment and taxation of " net income."

Confessedly the attempted classification must rest on some *reasonable basis* for distinction.

It must also " rest upon some difference indicating ' a reasonable and just relation to the act in respect of which the classification is proposed.' "

> *German Alliance Insurance Co.* v. *Hale*, 219 U. S. 307, 318.
>
> *Kidd, Dater Co.* v. *Musselman Grocer Co.*, 217 U. S. 461, 472.
>
> *Gulf, Colorado & Santa Fé R'y* v. *Ellis*, 165 U. S. 150, 165.

Meaning of " Reasonable and Just Relation " to the Act.

By this phrase must be meant that the classification must rest upon some material difference or factor which bears some fair and legitimate relation to the object of the legislation. Otherwise, the attempted classification would be arbitrary and fanciful.

Examples of inconsequential differences are thus referred to by Mr. Justice Brown:

> " Of course, if such discrimination were purely arbitrary, oppressive or capricious, and made to depend upon differences of color, race, nativity, religious opinions, political affiliations or other considerations *having no possible connection* with the duties of citizens as taxpayers, such exemption would be pure favoritism, and a denial of the equal protection of the laws to the less favored classes."
>
> *American Sugar Refining Co.* v. *Louisiana,* 179 U. S. 89, 92.

As Mr. Justice McKenna expresses it:

> " Equality of operation does not mean indiscriminate operation on persons merely as such, but on persons according to their relations.
>
> " In some circumstances it may not tax A more than B, but if A be of a different trade or profession than B it may. And in matters not of taxation, if A be a different kind of corporation than B, it may subject A to a different rule of responsibility to servants than B, *Missouri, Pacific Railway* v. *Mackey,* 127 U. S. 205, to a different measure of damages than B, *Minneapolis & St. Louis Railway* v. *Beckwith,* 129 U. S. 26, and it permits special legislation in all of its varieties."
>
> *Magoun* v. *Illinois Trust & Savings Bank,* 170 U. S. 283, 293, 294.

But the power to classify " is not without limitation, of course. ' Clear and hostile discriminations against partic-

ular persons and classes . . . might be obnoxious to the constitutional prohibition.'"

Magoun v. *Illinois Trust & Savings Bank* (*ibid.* p. 294).

But the differences in rate of taxation heretofore sustained have exclusively concerned excises, or property taxation on corporations of a peculiar or *quasi*-public nature, like railroads, telegraphs, sleeping-car and express companies.

No case can be found where it has been held that the real estate of a mining company may be taxed at one rate, a dry goods company at another and a woolen factory at another.

If such discrimination is not permissible, a direct tax upon income which is imposed at distinct rates on different kinds of ordinary trading, manufacturing or mining companies, contravenes the rule of equality equally well.

If so, a direct tax on income, prescribing different rules of valuation for the several kinds of companies and calculated or designed to reach different proportions of their "net income," or, in practice, producing such a result, must be fully as objectionable as a law expressly imposing distinct rates of taxation on the different classes of companies.

Conceding that the legislative body may arbitrarily impose varying *excises* upon different kinds of corporations, it by no means follows that direct taxes may be thus exacted.

Mr. Justice Brewer says, in a case involving a graduated inheritance tax imposed as an *excise:*

"It seems to be conceded that if this were a tax upon property, such increase in the rate of taxation could not be sustained, but being a tax upon the succession it is held that a different rule prevails."

Magoun v. *Illinois Trust & Savings Bank*, 170 U. S. 283, 302.

The learned justice, referring to that part of the act which classifies legatees into the three classes of near relatives, remote relations and strangers, at different rates of taxation for each, declares:

> " The classification is based upon differences which bear *just and proper relation* to it, and where classification is rightful, differences in the rate of taxation may be, so far as the *Federal Constitution* is concerned, permissible " (p. 301).

The professed object of this classification is the ascertainment and taxation of actual " net income."

The professed object of the Income Tax is to reach the " net income " of individuals and corporations, and to tax *all* corporations at the same rate.

If its real object, and the classification made in pursuance thereof, aim simply at the increase of revenue, to be derived from taxation of mining properties at a higher rate than other properties, this is not a legitimate object in direct taxation, for clearly A cannot be taxed at one rate, solely because of his ownership of land devoted to one kind of use, and B at a higher rate because his land has a distinct use.

The real object of the attempted classification is the proper determination and ascertainment of actual " net income " of corporations. There must be a reasonable basis for the distinction between mining and other corporations, and not a mere accidental or inconsequential difference. The classification, the differences of treatment, and the rule of taxation adopted must bear some fair relation to the object of the legislation, namely, the ascertainment of actual taxable " net income."

The rule adopted for valuation of the income of mines, namely, the deduction of a fixed percentage of gross receipts, to represent losses, does not reasonably or legitimately tend to the ascertainment of " net income." —

The distinction, the basis thereof, and the separate rules for valuation, bear no " just and proper relation " to the objects of the Act.

The only plausible argument which may be suggested in favor of the attempted classification, is that the real object of the Act is to ascertain and tax the actual " net income " of corporations, and that mining properties may properly be treated by a special rule of valuation, because of some unusual or peculiar difficulty in valuing such properties or their income. But the real trouble is that the rule of valuation adopted cannot possibly have the remotest bearing upon or relation to the ascertainment of " net income."

In the determination thereof, losses and depletion must always be deducted. Otherwise, what is taxed, is *principal*, and not income.

All other corporations may determine their *full* losses and depletion, according to the real facts, as determined by the evidence.

Mining companies are compelled to determine their losses solely according to the rule fixed by the Act, and applicable to them alone.

They may deduct 5% of their annual *gross receipts*, the value at the mine of their annual *gross* " *output.*"

What possible bearing can " gross receipts," or a percentage thereof, have, in the determination of losses and depletion, and, consequently, of " net income "?

Can gross receipts, in any way, indicate the total amount of deteriorating capital assets, or the extent of the depletion which has, in fact, occurred in a single year?

On the contrary, in the case of a mine, the amount of " gross receipts " can have no possible evidential value on the question of losses or depletion, unless accompanied with other evidence tending to show the length of life of the mine, and the proportions of capital and income represented by the " gross receipts," such evidence being pro-

hibited by the terms of the Act, which fixes, as the only test, a maximum deduction of 5%, regardless of the real facts.

It may, of course, be inferred that "gross receipts" of a mine include *some* capital, and thereby represent *some* losses, but *how much*, or to what extent, the test afforded by the Act has no influence whatsoever in determining.

If the mine is exhausted in one year, 100 per cent of the capital assets has been lost and has completely disappeared.

If its length of life is fifty years, only 2% of the total value of capital assets, whatever it may be, is lost in a single year.

In each case, the test adopted allows an arbitrary maximum deduction therefor of 5% of the "gross receipts." In the former case, this would permit the deduction of only a small percentage, to represent exhaustion of capital assets, when, in fact, the *whole* has been lost during the year.

This arbitrary percentage results, accordingly, in varying arbitrary discriminations between different mines, according to their length of life.

"Gross receipts" of a mine, less operating expenses, do not represent principal, wholly and exclusively, but include capital, in part, and income, in part.

> *Stratton's Independence L'd* v. *Howbert*, 231 U. S. 399.

This being the case, "gross receipts," taken alone, or an arbitrary percentage thereof, cannot possibly have any legitimate tendency to show the amount of losses or depletion of capital assets, or the amount of "net income," unless accompanied with other evidence, which the Act, in effect, forbids the use of, because of the adoption of an arbitrary fixed standard.

The classification and the purposes of the Act bear no "just and proper relation" to each other. The selection

of mines rests on no "reasonable basis for distinction," is purely arbitrary and unequal, and, therefore, unconstitutional.

That the 5% clause is purely arbitrary, is further shown by the fact that any other percentage, or equally immaterial tests, might equally well have been adopted.

As already shown, the test adopted by the Act is wholly immaterial and fanciful when it attempts to determine "net income" through deduction of a fixed percentage of "gross receipts."

It is still more clearly shown to be purely arbitrary, when we consider that the Act might equally well have provided for a 1% or 50% deduction from "gross receipts," to represent losses and depletion.

No such change, whatever its amount, would result in an approximation to actual losses, because the test itself is based on a wholly immaterial factor.

With equal logical bearing, the Act might have made the deduction for losses depend on a fixed percentage of annual wages, bank deposits, dividends or other casual tests having no possible tendency to show "net income."

For similar inconsequential tests,

cf. *American Sugar Refining Co.* v. *Louisiana*, 179 U. S. 89, 92.

"Gross receipts" may, in certain cases, have a logical bearing on the legislative object, but can never indicate the amount of "losses" or "net income."

Cases in which "gross receipts," or a percentage thereof, have been deemed a measure of the amount of business transacted, or of the size or wealth of a corporation, have no importance here, because, in such cases, "gross receipts" had some legitimate tendency to show a fact in controversy, while here they can have no possible bearing on or relation to the amount of losses or "net income."

Various *excises* have been sustained, when measured by " gross receipts " or " net income."

> *Spreckels Sugar Refining Co.* v. *McClain*, 192 U. S. 397.
>
> *Flint* v. *Stone Tracy Co.*, 220 U. S. 107, 166.

In some cases the size of the corporation or the amount of its deposits or receipts may be the index of the evil aimed at by the legislation, as in *Engel* v. *O'Malley* (219 U. S. 128), where the protection of small loans was the real object of the legislation, which exempted average deposits above $500. Mr. Justice Holmes there says:

> " It is true, no doubt, that where size is not an index to an admitted evil the law cannot discriminate between the great and small. But in this case size is an index " (p. 138).

So, also, the exemption of large steam laundries was held not to be arbitrary classification, because small hand laundries were made taxable. Mr. Justice Lamar, however, in his dissenting opinion, says:

> " It taxes some and exempts others engaged in identically the same business. It does not graduate the license so that those doing a large volume of business pay more than those doing less. On the contrary, it exempts the large business and taxes the small. . . . A discrimination founded on the personal attributes of those engaged in the same occupation and not on the value or the amount of the business is arbitrary."
>
> *Quong Wing* v. *Kirkendall*, 223 U. S. 59, 64, 75.

So, here, the mere size, importance, supposed wealth or " gross receipts " of mining companies cannot constitute a " reasonable basis " for classification, for purposes of direct taxation.

Investments in mining lands present no basic distinction from investments in other kinds of real estate, man-

ufacturing plants or other property.— Mere differences as to kind of property owned do not warrant a distinct rule for valuation of mining investments or their income, for purposes of direct taxation.

All nature is in a state of " flux," according to Heracleitus. Everything depreciates, even the pound sterling.

Deterioration, depreciation and depletion represent the same processes, though they may differ in degree.

Depreciation from age or wear and tear, when superficially considered, may seem to differ from depletion, in that the latter process results in some diminution in bulk of the deteriorating substance.

But, in essence, the apparently different processes do not differ at all.

Age, wear and tear equally result in loss of weight or change in the physical structure, arising from attrition or loss of the component particles. This may be illustrated by such deterioration of a building as is caused when the paint has been worn off. All other kinds of depreciation are of the same nature, although differing in degree. It would seem apparent that such unessential differences as occur between depreciation and depletion cannot be regarded as a " reasonable basis " for a classification which prescribes different rules for valuation of property or income, for purposes of direct taxation.

Admitting that railroads, possessing the right of eminent domain, and other public service corporations, running through different States, may have their property valued as a unit, or by special Boards of Appraisers, there remains the substantial question whether classification can be justified which places corporate investments in different classes, by distinguishing mining lands from timber lands, patent rights, manufacturing plants, or other forms of investment of business corporations, particularly when the classification involves distinct rules for valuation of property or income, instead of mere methods or details of assessment.

We have already considered the special doctrines concerning railroad, telegraph, sleeping-car, express and other public service companies, the peculiar nature of which may well justify classification, through the application of distinct rules for valuation of their property, for purposes of direct taxation, or even differences in the rate of taxation.

The decided cases in this Court have not yet gone further.

Here is presented the far-reaching problem whether different rates of direct taxation or distinct rules for valuation can be imposed on ordinary mercantile, manufacturing or mining corporations, or even on individuals, solely by reason of the fact that their investments represent one kind of property rather than another.

Of course, *excises* may be arbitrarily fixed at varying rates upon particular occupations, products or corporations, regardless of the fact that other classes are left untouched.

But can A be directly taxed at one rate and B at another?

Can physicians be taxed at the rate of 1% upon their net income, and lawyers at a 5% rate?

Can a mercantile corporation engaged in selling copper or manufactured brass products be taxed at 1%, a manufacturing corporation, like copper refining or brass works, at a 5% rate, and a mining company, which has its investment in the form of mining lands, rather than another kind of real estate, at a 10% rate?

Or can precisely the same thing be accomplished by adopting different rules of valuation calculated to reach or actually reaching different classes of private business corporations at different rates of taxation, *solely because* of differences in the form in which their capital may be invested?

If so, clearly there is no limit beyond which favoritism and arbitrary discrimination may not extend, in matters of taxation.

No case can be cited which has yet gone so far. Many cases have intimated or stated the contrary.

> *Gulf, Colorado & Santa Fé R'y* v. *Ellis*, 165 U. S. 150, 159.
>
> *Magoun* v. *Illinois Trust & Savings Bank*, 170 U. S. 283, 293, 294.
>
> *Cotting* v. *Kansas City Stockyards Co.*, 183 U. S. 79.
>
> *Southern R. R. Co.* v. *Greene*, 216 U. S. 400.

It would seem that mere differences in capital assets, as between one kind of real estate and another, can never form a " reasonable basis " for distinction or classification, for purposes of direct taxation.

To be sure, real estate may be taxed in one way and personal estate in another. Possibly one might be taxed exclusively, and the other not at all.

But can two different kinds of real estate, mining lands or farming lands, be made directly taxable at distinct rates of taxation? We submit that they cannot.

Mining lands, in no essential respect, differ from farming lands or other forms of real estate. — No reasonable basis can be suggested for classifying them separately, for purposes of direct taxation.

Of course, mining lands and other forms of real estate differ in certain respects.

Selection and classification necessarily involve differences, however slight or inconsequential they may be. But mere differences, or the possibility of classification, present no *reasonable basis* for distinction, for purposes of direct taxation, between mining lands and other kinds of real estate.

What *reasonable basis* can be suggested for directly taxing mining lands and other forms of real estate at different rates, or by distinct rules for valuation either of principal or income?

A mine is real estate, just like farming or other lands.

When the ore has been detached from the soil in which it is imbedded it becomes personal property.

> *Forbes* v. *Gracey,* 94 U. S. 762, 765, 766.
> *Buford* v. *Houtz,* 133 U. S. 320, 332.

The fruits and products of land, whether vegetable or mineral, until severed, are as much realty as the land itself or the rentals thereof.

> *Caldwell* v. *Fulton,* 31 Pa. St. 475, 483.
> *Pollock* v. *Farmers' Loan & Trust Co.,* 158 U. S. 601, 692.
> Co. Lit. 4 (*a*), 4 (*b*), 2 Bl. Comm. 18.

No Difference between Mining Lands and Timber Lands.

Ore, in place, is capital and is part of the real estate.

"It is just as much a part of the real estate as trees standing on the land."

> Judge Willard, *Von Baumbach* v. *Sargent Land Co.,* 207 Fed. 423, 432.

In the case of timber lands, it is well settled that the timber, when cut, is still part of the principal, and "the produce of it is invested and the interest only is paid to the tenant for life."

> *Romilly M. R., Daly* v. *Beckett,* 24 Beav. 114.

No reasonable basis for classifying mining lands can be suggested which would not equally apply to timber lands, because they are both real estate, and yet timber lands are exempted from the classification, which extends only to "mines," a limited form of real estate investment. Investments in patent rights are also excluded from the operation of the 5% clause, although they waste as rapidly as mines.

What has been said as to timber lands, remains equally true of all other classes of real estate, and, indeed, of all other forms of investment.

Mining lands are taxed at a higher rate, or upon an essentially different basis, on account of their " personal attributes," and *solely because* they are *mines*, rather than some other form of real estate investment, and *not* because the different forms of investment essentially vary according to some " reasonable basis " for distinction, or that they require different treatment or rules for valuation and taxation.

It cannot be urged in support of the classification that the valuation of mines or their income is more difficult than that of many other classes of real estate or of other forms of investment.

It may be urged that a *reasonable basis* for classification arises from the alleged fact that the valuation of mines, or their income, presents more difficulty than that of other classes of real estate or distinct forms of property.

A sufficient answer to this claim is that the valuation of railroads, telegraph lines, electric lighting or gas plants and express companies presents difficulties, in the way of valuing intangible assets, far beyond those involved in the valuation of a mine or its " net income."

Although the " ore deposits," being hidden in the ground, are incapable of exact physical measurement, expert opinion, based on " ore in sight," history of the ore district, and other material factors, may be resorted to with as much reliance as expert opinion concerning probable density of traffic, increase of gas or electric light consumption, and other factors constantly used in the determination of values of other kinds of property.

The fact that a mine represents a rapidly wasting principal, presents no reasonable basis for classification, because many other classes of property waste or deteriorate with equal rapidity, and in substantially the same way.

It may also be urged that mines are peculiar, in that their product largely represents a rapidly wasting principal. It is true that a mine may be exhausted rapidly or slowly, according to its length of life. But these inconsequential differences appear equally well in other cases, though, perhaps, mines deteriorate faster than appears in the case of some other kinds of investment property.

Every kind of property deteriorates in value.

Whether it be called depreciation or depletion, the process is essentially the same.

If the classification is rested on the basis that wasting properties are singled out, because of their peculiar nature, or because their product represents principal, in part, the classification is clearly objectionable, because all corporations in the same class, and under the same conditions, are not treated alike, for corporations owning timber lands, patent rights and the like, which waste in precisely the same way, and present the same problems, are exempted from the 5% clause, which applies exclusively to mines.

All within the same class, and subject to like conditions, must be treated alike.

Chicago Dock Co. v. *Fraley*, 228 U. S. 680, 687.
Selover, Bates & Co. v. *Walsh*, 226 U. S. 112.
Southwestern Oil Co. v. *Texas*, 217 U. S. 114, 121, 126.

There is " no fair reason for the law that would not require, with equal force, its extension to others whom it leaves untouched."

If there is no such " fair reason," a classification is unreasonable and purely arbitrary, as is well settled.

Barrett v. *Indiana*, 229 U. S. 26, 30.
International Harvester Co. v. *Missouri*, 234 U. S. 199, 214.
Watson v. *Maryland*, 218 U. S. 173, 179.

It is apparent that any fair reason which might be suggested for this Act would require, "with equal force," its extension to companies owning timber lands, patent rights and the like, and, indeed, to all other classes of corporations.

The discrimination against mines is of an "unusual character" wholly "unknown to the practice of our governments," and is pure favoritism, class legislation and palpably arbitrary classification, resting upon no reasonable basis for distinction.

As was stated by Mr. Justice Bradley, with reference to discrimination in taxation:

> "All such regulations, . . . so long as they proceed within *reasonable limits* and *general usage*, are within the discretion of the State legislature. . . .
>
> "But clear and *hostile discriminations* against particular persons and classes, especially such as are of an *unusual character, unknown* to the practice of our governments, might be obnoxious to the constitutional prohibition."
>
> *Bell's Gap R. R. Co.* v. *Pennsylvania*, 134 U. S. 232, 237.

The discrimination against mines proceeds on wholly new and *unusual* principles. Indeed, it is wholly contrary to the practice of the Federal Government, for in the immediately preceding Federal Corporation Excise (Act of August 5, 1909, Sec. 38, paragraph 2), the fullest opportunity was granted to *all* corporations to deduct their *entire* losses, including a *reasonable allowance* for depreciation of property, if any.

In like manner, the Treasury Regulations thereunder (Circular of February 14, 1911, Rulings 81–84) specifically allowed *all* losses, through depletion of ore deposits, to be deducted, in the case of mines, by excluding entirely from the item of *gross income* the value of capital assets mined and disposed of during the year.

After consciously adopting a fair and just rule for ascertainment of the actual "net income," which allowed *all* proper losses and depletion to be considered, the Government two years later adopted this arbitrary 5% clause, which does not, in the case at bar, and can rarely, if ever, permit a "reasonable allowance," but, by its very conditions, requires an *unreasonable* and totally inadequate allowance, not intended to compensate for *all* actual losses.

If this is not "clear and hostile" discrimination against "particular persons and classes," solely because of their ownership of a particular form of invested capital, it is difficult to conceive what would constitute a case of *consciously hostile* discrimination.

The clause was obviously inserted simply because, under the fair rules prescribed by the preceding Act, the Government did not receive what it deemed to be a sufficient revenue from mining companies, and, therefore, it proceeded to lay down an arbitrary rule of valuation for them alone, which results, in effect, in their paying income taxes at a rate, upon their *actual* income, equivalent to twice as much as any other class of corporations, if not more.

Act Open to Other General Constitutional Objections, Founded on Palpably Arbitrary Discrimination against All Corporations.

The Act further discriminates unlawfully against all corporations, by classifying individuals and corporations and allowing the former a $4,000 exemption, and by granting exemptions to labor, agricultural and other organizations. These general objections seem sound, but are not here treated at length, because fully argued in the other cases heard with this case.

III.

Double Taxation, in Case of Operating Corporations Controlled by Holding Companies.

Double taxation, in the case of operating corporations controlled by holding companies, furnishes an additional ground for claiming that the Income Tax law levies unequal and arbitrary taxation, contrary to " due process " and " equal protection of the laws."

Such a company must, in effect, pay a double tax:

(1) Upon its own earnings directly;

(2) Upon its dividends, paid out of earnings, the tax being collected from shareholders owning its entire capital stock, or nearly so.

The case, therefore, comes within the proper definition of " double taxation." It is undoubtedly true that " double taxation in a legal sense does not exist unless the double tax is levied upon the *same* property within the same jurisdiction."

Ohio Tax Cases, 232 U. S. 576, 593, 594.

For purposes of taxation, the corporation may be taxed on its whole capital stock and the individual shareholder may also be taxed for his distinct property interest, represented by his shares.

New Orleans v. *Houston*, 119 U. S. 265, 277.

It has, indeed, been stated generally that " double taxation " is not open to any constitutional objection.

Davidson v. *New Orleans*, 96 U. S. 97, 106.

But it is universally recognized that " justice requires that the burdens of government shall, as far as is practicable, be laid equally on all, and, if property is taxed once in one

way, it would ordinarily be wrong to tax it again in another way, when the burden of both taxes falls on the same person."

Tennessee v. *Whitworth*, 117 U. S. 129, 136.

But none of the decided cases disposes of our contention that whether double taxation is constitutionally objectionable or not, the Income Tax law denies " equal protection of the laws " and " due process of law," because it unlawfully and arbitrarily classifies and discriminates against holding companies, and operating companies owned by holding companies, by subjecting them to double taxation, when all other corporations, and all individuals, as well, are liable only for a single tax.

Under the Income Tax law (Sub-Section B, paragraph 7, of Section 2, Act of October 3, 1913) all individuals are allowed to deduct "the amount received as dividends upon the stock or from the net earnings of any corporation" which is taxable upon its " net income."

Corporations are not allowed to make such deduction [Sub-Section G (*b*)].

Accordingly, the taxable income of holding companies includes " dividends " received by them from the operating companies which they own.

The obvious result is that holding companies pay a tax on *dividends* collected, while individuals, under like circumstances and conditions, pay *no* tax on their *dividends*.

Holding companies and operating companies pay taxes, not only on the net profits of the operating company, but also on the dividends paid out of its earnings, which, in effect, is double taxation, but, if not, is gross discrimination against them and favoritism to other corporations and all individuals, based on no reasonable grounds for distinction.

Assuming that class legislation of this kind, as between individuals and corporations, would be constitutional, the fundamental objection still remains that *all* corporations,

under like conditions, are not treated alike, as " equal protection " necessarily requires.

No reasonable ground can be stated why an operating company can thus be discriminated against, solely because its capital stock has been purchased by a holding company; nor, on the other hand, why the holding company can be subjected, in effect, to double taxation, solely because it has chosen to invest its capital in shares, rather than in a manufacturing plant or other form of investment.

Further discrimination is shown by the fact that *all* the shares of the operating company, or the dividends thereon, are not taxable, but only those held or received by a holding company.

The cases previously cited under II make it sufficiently clear that classification has never yet been supported as reasonable, when based on such capricious and arbitrary grounds for distinction, resting on no reasonable basis.

IV.

UNDER THE FIFTH AMENDMENT, CONGRESS IS PROHIBITED FROM ENACTING LAWS WHICH ARE PALPABLY ARBITRARY AND UNEQUAL, RESTING UPON NO REASONABLE BASIS FOR CLASSIFICATION. SUCH LAWS DEPRIVE A TAXPAYER OF HIS PROPERTY WITHOUT DUE PROCESS OF LAW. — THE FIFTH AMENDMENT, HOWEVER, ALLOWS REASONABLE CLASSIFICATION. — SUCH LAWS ALSO ARE VOID, BECAUSE THEY VIOLATE THE IMPLIED LIMITS TO THE POWER OF TAXATION WHICH ARE INHERENT IN OUR FORM OF GOVERNMENT.

Congress, precisely like the States, is limited to making reasonable classifications which rest upon some fair basis for distinction, and cannot select objects or prescribe rules for taxation in a palpably arbitrary and capricious manner.

This proposition may be supported upon two distinct grounds, viz.:

(1) A law which imposes taxes arbitrarily and unequally, without any reasonable basis for selection or classification, necessarily deprives the taxpayer of his property without " due process of law," within the meaning of the Fifth Amendment.

The " due process " clause guarantees the " equal protection of the laws " to this extent, at least.

(2) The power of taxation, in itself, apart from express provision in the Constitution, necessarily implies some limitations upon the taxing body, whether it be Congress or a State, including the lack of power to exact arbitrary, unequal and oppressive taxes, without regard to any resonable basis for classification.

Taxation which is palpably arbitrary, unequal and oppressive deprives the taxpayer of his property without " due process of law," as guaranteed by the Fifth Amendment.

It is true that the Fifth Amendment does not, in terms, guarantee " equal protection of the laws " to all persons and corporations, with respect to action by Congress, whereas such protection is expressly granted by the Fourteenth Amendment as to State laws.

The mere omission of these words in the Fifth Amendment is not controlling.

Nor is it particularly significant, any more than is the fact that the Fifth Amendment prescribes that private property shall not " be taken for public use, without just compensation," while the Fourteenth Amendment is silent upon the subject.

No one could maintain that such a taking could be made by the States, because it is not specifically prohibited by the Fourteenth Amendment.

Likewise, the fact that the Fifth Amendment does not expressly guarantee " equal protection of the laws," does not, in any way, imply that arbitrary, unequal and oppressive legislation may be enacted by Congress, without vio-

lating " due process of law " as guaranteed by this Amendment.

What is " due process of law," within the meaning of the Fifth Amendment?

Is Congress limited, to any extent, in its powers of taxation, by reason of this provision?

Often Assumed by This Court that Congress Cannot Arbitrarily Discriminate in Its Legislation

It has often been stated by this Court that " due process," under the Fifth Amendment, can, in no event, extend further than to require " equal protection of the laws," as interpreted in decisions under the Fourteenth Amendment, including the right of the legislative body to make all reasonable classifications.

It is not necessary to establish the proposition that " due process of law " and " equal protection of the laws " are absolutely identical, although it is probably true that these clauses coincide to this extent, that " due process " always requires " equal protection of the laws."

It suffices if we can show that " due process " prohibits Congress from selecting objects and rules for taxation arbitrarily, capriciously, unequally and oppressively, without regard to any reasonable basis for selection or classification.

> " Even if it be assumed that that clause [" due process of law "] is equivalent to the ' equal protection of the laws " clause of the Fourteenth Amendment, *which is the most that can be claimed for it here,* it does not take from Congress the power to classify, nor does it condemn exertions of that power merely because they occasion some inequalities. On the contrary, it admits of the exercise of a wide discretion in classifying according to general, rather than minute, distinctions, and *condemns*

> *what is done only when it is without any reasonable basis,* and therefore *is purely arbitrary.*"
>
> *Mr. Justice Van Devanter, Second Employers' Liability Cases,* 223 U. S. 1, 52, 53.

It was likewise assumed throughout *Flint* v. *Stone Tracy Co.* (220 U. S. 107) that the taxing powers of Congress were subject to some limitations, under the Fifth Amendment, and that, if the Federal Corporation Excise Act, there sustained, could have been shown to be palpably arbitrary and unequal in its classifications, the Act would have been held unconstitutional. Otherwise, the Court would not have felt itself compelled to discuss, in detail, and to reject (pp. 158 to 161, 165) all the different claims there raised, to the effect that the Act was arbitrary and unequal, because it taxed corporations, while omitting to tax partnerships and individuals carrying on the same lines of business, and because it allowed numerous exemptions.

It was there clearly assumed that, if the measurement of the tax was unequal, arbitrary and baseless, the Act must fail, under the Fifth Amendment, even though it involved an *excise,* and not direct property taxation.

Mr. Justice Day says:

> " It is contended that measurement of the tax by the net income of the corporation or company received by it from all sources is not only unequal, but so *arbitrary* and *baseless* as to fall outside of the authority of the taxing power " (p. 165).

The Court, however, decided that the measurement of the tax and the classification between corporations and individuals were placed upon a reasonable basis, and were not arbitrary, or unequal, and were, therefore, constitutional.

In other cases a similar assumption has been made, to the effect that " *due process,*" under the Fifth Amendment, forbids arbitrary and unlawful classification, and, indeed,

requires the United States to conform to the constitutional requirement of "equal protection of the laws."

United States v. *Heinze*, 218 U. S. 532.
District of Columbia v. *Brooke*, 214 U. S. 138.

These statements by the Court would seem, in themselves, to establish our position that even the taxing power of Congress is subject to some limitations, under the Fifth Amendment, and that legislation is condemned thereby which selects objects and rules of valuation arbitrarily and "without any reasonable basis."

But we shall proceed to discuss more broadly the meaning of "due process of law" and to show that taxation laws which do not afford "equal protection of the laws," because they are unequal, palpably arbitrary, capricious or oppressive, must, of necessity, deprive persons of their property "without due process of law."

Meaning of "Due Process of Law," under the Federal Constitution.

It is unnecessary, as well as impossible, to define "due process of law" so as to cover all cases.

This Court has consistently refused to attempt a broad definition but has stated many of the elements covered by "due process," as the cases have arisen.

The phrase, obviously, is not limited to Court proceedings, as its terms seem to imply. Indeed, the most important questions arising under it have been concerned with legislation.

The phrase, in its present form, seems to have originated in Edward the Third's Confirmation of Magna Charta in 1354 (cap. 3).

But its real meaning, "the law of the land," was expressed in the famous clause "*vel per legem terrae*" in the Magna

Charta of King John (cap. 39), as amplified in the corresponding words in the Magna Charta of Henry III: "*dissaisietur . . . de libero tenemento suo, vel libertatibus, vel liberis consuetudinibus suis.*"

Davidson v. *New Orleans*, 96 U. S. 97.
Murray's Lessee v. *Hoboken Land & Improvement Co.*, 18 How. 272, 276.

Indeed, the principle of equality before the law antedated Magna Charta, appearing in the Charter of Liberties of Henry II in 1154.

See

Taswell-Langmead, English Constitutional History (6 ed.), quoting Coke (pp. 104, 107).
Taylor, Origin and Growth of the English Constitution, Vol. 2, p. 3.
Stimson's Federal and State Constitutions of the United States, pp. 75, 80, 90.

Words in the Federal Constitution are construed according to the full historical meaning which they had acquired prior to its adoption.

Cooley, Principles of Constitutional Law (4 ed.), p. 387.
Mattox v. *United States*, 156 U. S. 237.
Kepner v. *United States*, 195 U. S. 100.

In the different constitutions, Federal and State, the phrases "due process of law" and "law of the land" seem to be used interchangeably, and are practically synonymous.

As was said in *Harding* v. *People* (160 Ill. 459), the phrases "due process of law" and "law of the land" are synonymous and "refer to general public law operating upon all alike, and not to such as singles out for regulation, without reason, particular persons and classes."

Corporations, of course, are protected by the clause be-

cause they are persons, within the meaning of the property clauses of the Fifth and Fourteenth Amendments.

Southern Railway v. *Greene*, 216 U. S. 400.

As defined by Mr. Cooley,

"Due process of law, in each particular case, means such an exertion of the powers of government as the settled maxims of law permit and sanction, and under such safeguards for the protection of individual rights as those maxims prescribe for the class to which the one in question belongs." . . .

"It was not within the power of the States before the Fourteenth Amendment to deprive citizens of the equal protection of the laws."

Cooley, Const. Limitations, pp. 434, 490.

Both the Fifth and the Fourteenth Amendments presuppose equality before the law, which is a fundamental necessity inhering in our form of government, and not requiring express statement in the Constitution.

As has been well stated by Mr. Justice Matthews:

"When we consider the nature and theory of our institutions of government, the principles upon which they are supposed to rest, and review the history of their development, we are constrained to conclude that they do not mean to leave room for the play and action of purely personal and arbitrary power."

Yick Wo v. *Hopkins*, 118 U. S. 356, 369, 370.

That equality before the law is inherent in our form of government is further apparent from the terms of the Declaration of Independence:

"We hold these truths to be self-evident, that all men are created equal, that they are endowed by their Creator with certain unalienable rights, that among these are life, liberty and the pursuit of happiness."

Referring to this statement, Mr. Justice Brewer says:

"While such declaration of principles may not have the force of organic law, or be made the basis of judicial decision as to the limits of right and duty, and while in all cases reference must be had to the organic law of the nation for such limits, the latter is but the body and the letter of which the former is the thought and the spirit, and it is always safe to read the letter of the Constitution in the spirit of the Declaration of Independence.

"No duty rests more imperatively upon the Courts than the enforcement of those constitutional provisions intended to secure that equality of rights which is the foundation of free government."

Gulf, Colorado & Santa Fé R'y v. *Ellis*, 165 U. S. 150, 159, 160.

The result of the opposite view is well stated by Judge Catron (afterwards Mr. Justice Catron of this Court):

"Were this otherwise, odious individuals and corporate bodies would be governed by one rule, and the mass of the community, who made the law, by another."

Vanzant v. *Waddel*, 2 Yerger, 260, 270.

It cannot be doubted that, apart from express provision, statutes are clearly unconstitutional which are based upon fanciful distinctions such as are referred to by Mr. Justice Brewer in *Gulf, Colorado & Santa Fé R'y* v. *Ellis*, *supra*, p. 155, as where liability for extra costs or attorney's fees is imposed on white men, but not on black men, or on men beyond a certain age or possessed of a certain amount of wealth, and not on others, or where legal capacity to contract is made dependent upon stature or the color of the hair, for "such a classification for such a purpose would be arbitrary and a piece of *legislative despotism*, and therefore not the law of the land" (*State* v. *Loomis*, 115 Missouri, 307, 314).

It is obvious that some limitations on the power of Congress must inhere in the very nature of our Government,

as well in the power to tax, entirely apart from the express provisions of a written Constitution.

Meaning of " due process of law." — Palpably arbitrary classification, for purposes of taxation, without any reasonable basis, violates " due process of law," as guaranteed by the Fifth Amendment.

We are not here immediately concerned with the question whether the spirit of the entire Constitution and the fundamental principles of a free government forbid arbitrary discrimination, inequality and oppression in the laws passed by Congress, apart from the express prohibitions of the Constitution.

The real question is, whether palpably arbitrary discrimination, based on no reasonable classification, can be exercised by Congress in direct taxation, without violating " due process of law."

Process of law is " due " only when it operates with " equality," as interpreted under the Fourteenth Amendment, and in accordance with established principles of private right and distributive justice.

So far as taxation laws are concerned, it has always been recognized that taxes, so far as possible, should be imposed equally, impartially and uniformly upon all similarly situated.

Absolute and perfect equality is unattainable, but glaring and palpably arbitrary or intentional discriminations have no constitutional sanction.

For purposes of direct taxation, reasonable classification is allowable, but only to the same extent that it is permitted under the " equal protection " clause of the Fourteenth Amendment.

The words of Magna Charta, as incorporated in the Maryland Declaration of Rights, are:

> " No freeman ought to be taken or imprisoned, etc., or deprived of his life, liberty, or property, but by the judgment of his peers, or by the law of the land."

Referring to these terms, Mr. Justice Johnson says:

"After volumes spoken and written with a view to their exposition, the good sense of mankind has at length settled down to this: that they were intended to secure the individual from the arbitrary exercise of the powers of government, unrestrained by the established principles of private rights and distributive justice."

Bank of Columbia v. *Okely*, 4 Wheat, 235, 244.
In re Kemmler, 136 U. S. 436, 448.

As stated by Mr. Justice Brown:

"This Court has never attempted to define with precision the words 'due process of law,' nor is it necessary to do so in this case. It is sufficient to say that there are certain immutable principles of justice which inhere in the very idea of free government which no member of the Union may disregard."

Holden v. *Hardy*, 169 U. S. 366, 389.
Scott v. *McNeal*, 154 U. S. 34, 45.

The phrase "cannot be so construed as to leave Congress free to make any process 'due process of law' by its mere will."

Mr. Justice Curtis, *Murray's Lessees* v. *Hoboken Land Co.*, 18 How. 272, 276.

"Due process" is secured by "laws operating on all alike, and not subjecting the individual to the arbitrary exercise of the powers of government unrestrained by the established principles of private right and distributive justice."

Chief Justice Fuller, in Leeper v. *Texas*, 139 U. S. 462, 468.
Hurtado v. *California*, 110 U. S. 516, 535.
Duncan v. *Missouri*, 152 U. S. 377.
Twining v. *New Jersey*, 211 U. S. 78, 101, 102.

The theory has been suggested that, in tax statutes, the legislative body is permitted to exercise a more unbridled latitude in discriminating and classifying than in the case of regulating laws.

But that there is any difference in this respect, has often been denied.

As Mr. Justice McKenna says, in his dissenting opinion, in *Connolly* v. *Union Sewer Pipe Co.* (184 U. S. 540, 570):

> " The principle of classification, therefore, is not different in tax laws than in other laws. That principle, as I have said, necessarily implies discrimination between the persons composing the class and other persons. The equality prescribed by the Constitution is fulfilled if equality be observed between the members of the class."

See

Cox v. *Texas*, 202 U. S. 446, 450, 451.

But whether tax laws differ from others, is an unnecessary inquiry here, for it is well established that the power of taxation, however extensive, is not unbridled.

There are limits even to the tax powers of Congress.

If taxation is palpably arbitrary, unequal and oppressive, and the attempted classification rests on no reasonable basis, it violates " due process of law."

And this is true, regardless of the question whether " equal protection " and " due process " are precisely equivalent phrases.

No Such Thing as Unlimited Power of Taxation in Congress. — Equality and Uniformity an Inherent Necessity in All Taxation.

Adopting the language of counsel, Mr. Justice Field stated in *Pollock* v. *Farmers' Loan & Trust Co.* (157 U. S. 429, 599):

> " There is no such thing in the theory of our national government as unlimited power of taxation in Congress.

"There are limitations . . . of its powers arising out of the essential nature of all free governments; there are reservations of individual rights, without which society could not exist, and which are respected by every government. The right of taxation is subject to these limitations."

Among these limitations is the established rule that the power of taxation can only be exercised in aid of some public object, and not in favor of private enterprises, even though no such limitation is expressed in the Constitution.

Loan Association v. *Topeka*, 20 Wall. 655.
Parkersburg v. *Brown*, 106 U. S. 487.

Gross discriminations in former Income Tax would probably have rendered it unconstitutional, if it had not been held so on other grounds.

Other necessarily implied limitations are of the character here insisted upon.

As stated by Mr. Justice Field:

"The inherent and fundamental nature and character of a tax is that of a contribution to the support of the government, levied upon the principle of equal and uniform apportionment among the persons taxed, and any other exaction does not come within the legal definition of a tax.

"This inherent limitation upon the taxing power forbids the imposition of taxes which are *unequal* in their *operation upon similar kinds* of property, and necessarily strikes down the gross and arbitrary distinctions in the income law as passed by Congress. . . . *Trifling differences* in their modes of business, but not in their results, are made the ground and occasion of the greatest possible differences in the amount of taxes levied upon their income, showing that the action of the legislative power upon them has been arbitrary and capricious and sometimes merely fanciful" [language particularly applicable to the gross discrimination against mines here shown].

Pollock v. *Farmers' Loan & Trust Co.*, 157 U. S. 429, 599, 600.

Palpably arbitrary classification is not " due process."

" In judging what is ' due process of law,' respect must be had to the cause and object of the taking, whether under the taxing power, the power of eminent domain or the power of assessment for local improvement or none of these; and if found to be suitable or admissible in the special case, it will be adjudged to be ' due process of law '; but *if found to be arbitrary, oppressive and unjust, it may be declared to be not ' due process of law.'* "

Justice McKenna, *Ballard* v. *Hunter*, 204 U. S. 241, 255, 256.

In *Magoun* v. *Illinois Trust & Savings Bank* (170 U. S. 283, 294), Mr. Justice McKenna states that the power of classification even for purposes of taxation, " is not without limitation, of course," quoting in approval the statement of Mr. Justice Bradley in *Bell's Gap Railroad* v. *Pennsylvania* (134 U. S. 232, 237).

Mr. Justice Brewer, in his dissenting opinion in the same case, states the same general doctrine thus:

" But when a tax law directly, necessarily and intentionally creates an inequality of burden, it then becomes imperative to inquire whether this inequality thus intentionally created can find any constitutional justification " (p. 301).

It was assumed, though not directly decided, in the oleomargarine case, that palpably arbitrary classification, for purposes of taxation, indulged in without any reasonable basis, violates " due process " under the Fifth Amendment, but the Court there found that there was no abuse of the taxing power in imposing a tax on oleomargarine artificially colored so as to look like butter, while leaving untaxed artificially colored natural butter.

Mr. Justice White there says:

" Conceding merely for the sake of argument that the due process clause of the Fifth Amendment would avoid an exertion of the taxing power which, without any basis

for classification, arbitrarily taxed one article and excluded an article of the same class, such concession would be wholly inapposite to the case in hand" (p. 61). . . .

"Let us concede that, if a case was presented where the abuse of the taxing power was so extreme as to be beyond the principles which we have previously stated, and where it was plain to the judicial mind that the power had been called into play, not for revenue but solely for the purpose of destroying rights which could not be rightfully destroyed consistently with the principles of freedom and justice upon which the Constitution rests, that it would be the duty of the courts to say that such an arbitrary act was *not merely an abuse* of a delegated power, but was the exercise of an authority not conferred" (p. 64).

With this concession, however, the learned justice very properly concludes that the "manufacture of artificially colored oleomargarine may be prohibited by a free government without a violation of fundamental rights."

McCray v. *United States,* 195 U. S. 27.

"Equality" Clause Merely Declaratory.

The provisions of the Fourteenth Amendment regarding equality are merely declaratory of the law as it had long existed.

The provision guaranteeing "equal protection" was merely a restatement of an old idea.

In 1778 Sir William Meredith, speaking of the importance of equal laws, says:

"If many a page in the history of worldly interest and ambition did not prove the fact, it would be thought incredible that, in a country of liberty, men can be found ready to promote measures that destroy that property in equal laws, which constitutes the best part of a free man's inheritance."

Historical Remarks on the Taxation of Free States (1778), p. 39.

This provision as to "equal protection," apparently, was fully covered by the previous clause requiring "due process," but was added out of abundant caution, just as in the Fifth Amendment we find the clause added: "nor shall private property be taken for public use, without just compensation."

Such a taking would clearly be wanting in "due process," without express provision.

Similarly, the fact that the Fifth Amendment omits the clause as to "equal protection," furnishes no possible ground for the argument that Congress may enact laws which are palpably arbitrary, unequal, unjust and oppressive.

No such extraordinary argument will probably be advanced here.

If it be conceded that a taxing Act of Congress is palpably arbitrary, unequal and oppressive, it follows necessarily that it lacks "due process" and violates the Fifth Amendment.

Government attitude as to Federal Corporation Excise impliedly admitted that Congress is bound to tax equally and uniformly.

If anything further were necessary to be said, a strong argument in our favor may be derived from the attitude of the Government in the *Stone Tracy* case, where all possible varieties of objection were urged to the constitutionality of the Federal Corporation Excise, based on the lack of reasonable classification, all of which were fully considered and rejected by the Court, an entirely useless proceeding, unless Congress is subject to such limitations to its powers of taxation.

In the brief presented in behalf of the Government in that case, although the question there concerned an *excise*, and not a direct tax on property or income, the learned counsel made no attempt to argue that Congress is unlimited in its powers of taxation, by reason of the omission of the "equal protection" clause from the Fifth Amendment.

Insisting that proper classification had been made, their brief begins (p. 119) the consideration of that question in these terms:

> "However the Court may view the question of the existence of any other than the express constitutional rule concerning uniformity in excise taxation, it must at least be true that any implied rule of uniformity will no more confine the discretion of Congress in deciding what or how it will tax than the general language of the Fourteenth Amendment, prohibiting denial of the equal protection of the laws by a State, confines the State legislatures in their taxing discretion."
>
> *Government Brief in Flint* v. *Stone Tracy Co.* (220 U. S. 107).

We should expect the Government to take the same correct attitude here, in view of the authorities above cited regarding limitations upon the power of Congress to tax, whether arising from the "due process" clause, the fundamental ideas of our government, or the inherent nature of taxation.

We maintain, therefore, that, if the present direct tax can be shown to be palpably arbitrary, unequal and oppressive, as regards mines, it is wanting in "due process," and is unconstitutional, under the Fifth Amendment.

The obvious limitations upon the tax powers of Congress are not affected by the Sixteenth Amendment, so far as property taxation is concerned, except that it authorizes direct income taxes, when they are not arbitrary, unequal or oppressive.

However startling such a proposition may be, it is possible that it may be claimed that, so far as income taxes are concerned, the questions raised as to their arbitrariness, inequality and oppressiveness are no longer open, because of the express authorization of income taxes by the Sixteenth Amendment.

Mere reference to the terms of the Sixteenth Amendment would seem to answer such a claim. It provides:

> "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration."

This amendment was adopted because of the unconstitutionality of the Income Tax of 1894, as determined in *Pollock* v. *Farmers' Loan & Trust Co.* (157 U. S. 429; 158 U. S. 601), where it was held that such an income tax, being a direct tax, was unconstitutional, because it was not apportioned among the several States according to their respective numbers.

Matters Settled by Pollock Decision.

In the *Pollock* case, four matters were decided:

First: That a tax upon real estate is a direct tax.

Second: That a tax upon personalty is likewise a direct tax, as no sound distinction exists between a tax levied upon a person solely because of his general ownership of real estate, and a tax so levied, solely because of his general ownership of personal property.

Third: That a tax upon the income derived from property, whether real or personal, is the legal equivalent of a direct tax upon the property from which such income is derived, and is, therefore, a direct tax, and must be apportioned.

Fourth: That while that tax also covered all other sources of income, like professional incomes, not derived from property or investments, such other classes of income were so inextricably blended, under the terms of the Act, with income derived from property, that the whole Act formed one indivisible scheme of taxation; that it could not, for a moment, be supposed that Congress would have taxed such other forms of income, if it had understood that the

tax on incomes from real and personal property would be held to be invalid; and, consequently, that the whole Act must be deemed to be unconstitutional.

See

Knowlton v. *Moore*, 178 U. S. 42, 82.

Sixteenth Amendment merely obviated the objection founded on lack of apportionment, leaving open all other constitutional objections to an income tax.

The possible claim here considered is whether all constitutional objections to income taxes other than those arising from lack of apportionment are wiped out, by implication, through the ratification of the Sixteenth Amendment, so that it is no longer possible to argue that income taxes which violate " due process of law " are unconstitutional.

Such an extraordinary claim would seem not to require extended argument.

It might equally be contended that the general grant of the " power to lay and collect *taxes* " (Art 1, Sec. 8, clause 1) concludes all discussion as to the constitutionality of taxes which violate " due process " or the inherent nature of the taxing power.

The Sixteenth Amendment was merely intended to obviate one of the constitutional objections raised against an income tax, namely, the lack of apportionment.

No one would now contend that, because income taxes are expressly authorized, without regard to apportionment, any and all kinds of income taxes, however fantastic, arbitrary and oppressive, may be imposed.

Obviously, this amendment was intended to go no further than its terms indicated.

All forms of direct taxation of real and personal property, other than income taxes, still require apportionment; otherwise they are unconstitutional.

Pollock v. *Farmers' Loan & Trust Co.* (*supra*).

Direct taxation upon incomes must still be imposed subject to the rule of equality and uniformity.

The suggestion that the "due process" clause is impliedly repealed by the Sixteenth Amendment, so far as income taxes are concerned, is wholly untenable.

The fundamental guaranties of that clause and the immense body of judicial decision thereunder cannot lightly be swept away by implication, certainly not, unless the terms of the Amendment clearly indicate the intention to repeal them as to income taxes.

V.

FIVE PER CENT CLAUSE IS SEPARABLE FROM REMAINDER OF INCOME TAX LAW. — IT MAY BE DECLARED UNCONSTITUTIONAL AND THE REMAINDER OF THE ACT ALLOWED TO STAND. — OR THE LAW MAY BE DECLARED VOID, AS APPLIED TO MINES.

The 5% clause has been shown to be unconstitutional, as we maintain. The rest of the Income Tax law may prove to be unobjectionable. The 5% clause has no necessary connection with the remaining provisions.

If so, this Court may declare the separable provision unconstitutional and void, and uphold the remainder of the Act.

Or it may declare the Income Tax to be void, as applied to mines, and otherwise to be constitutional.

> "Whenever an Act of Congress contains unobjectionable provisions separable from those found to be unconstitutional, it is the duty of this Court to so declare, and to maintain the act in so far as it is valid."
>
> *El Paso & N. E. R'y* v. *Gutierrez*, 215 U. S. 87, 96.
> *Flint* v. *Stone Tracy Co.*, 220 U. S. 107, 177.

This principle is familiar.

It will be followed by the Court, except where the main

purpose of the Act is declared to be unconstitutional. Where the Court may fairly infer that Congress would still have enacted the law, notwithstanding the elimination of objectionable provisions which are easily separable, the remainder of the law may be allowed to stand. This is the case here.

Even if the 5% clause were eliminated, or had been supposed to be unconstitutional, it is clear that Congress would still have enacted the main provisions of the Income Tax law.

Accordingly, the 5% clause may be treated separately and declared unconstitutional and void.

See

> *Pollock* v. *Farmers' Loan & Trust Co.*, 158 U. S. 601, 637.
> *Willcox* v. *Consolidated Gas Co.*, 212 U. S. 19, 53, 54.
> *Southwestern Oil Co.* v. *Texas*, 217 U. S. 114, 121.
> *Berea College* v. *Kentucky*, 211 U. S. 45, 54, 55.
> *Ohio Tax Cases*, 232 U. S. 576, 594.

Summary of Appellant's Claims.

In conclusion, we submit that the 5% clause is unconstitutional and void, or that the Income Tax law, as applied to mines, is so, for the following main reasons:

(1) Because the natural or necessary effect of the clause, when the real substance of things is reached, is to tax directly *some portion* of the Company's *principal* as if it were income, without apportionment according to population, and, indeed, a very substantial amount of its capital assets.

(2) Because it violates " due process of law " and " equal protection of the laws " in the following respects:

(*a*) Because it is palpably arbitrary classification, for purposes of taxation, resting on no reasonable basis for distinction.

(*b*) Because it cannot fairly be suggested that there is

any " fair reason for the law that would not require, with equal force, its extension to others whom it leaves untouched."

(*c*) Because the classification and the purpose of the Act, namely, the ascertainment of " net income " for purposes of taxation, must bear some " reasonable and just relation " to each other.

This classification of mining companies, as against other classes of corporations, rests wholly upon accidental, inconsequential differences which have no material or just bearing upon the purposes of the legislation.

A deduction from " gross receipts " can have no possible bearing on or relation to the purpose of the Act, namely, to ascertain and tax " net income."

(*d*) Because the Act arbitrarily imposes one rule for valuation of income, or, in effect, a different rate of direct taxation on one kind of business corporation and a different rule or rate on another kind.

(*e*) Because the law does not apply equally to all within the same classification, for it affects different corporations in distinct ways, mining companies being discriminated against, although in the class composed of corporations, all of which are under like conditions, so far as the same are material.

(3) Because the taxation is especially discriminatory, unequal and arbitrary, when the effect on holding and operating companies is considered, amounting to double taxation, whereas all other corporations and all individuals, even individual shareholders in the same operating company, are subjected only to a single tax.

(4) Because the $4,000 exemption of individual incomes and the exemption of labor, agricultural and other organizations unlawfully discriminates against all corporations.

CHARLES A. SNOW,
Counsel for Appellant.

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Supreme Court of the United States.

OCTOBER TERM, 1915.

No. 359

(24572)

JOHN R. STANTON,

Appellant,

vs.

BALTIC MINING COMPANY, ET AL.,

Appellees.

Brief Supporting Position of Appellant.

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CASES CITED.

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No. ......

(24572)

JOHN R. STANTON,

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STATEMENT.

This is an appeal from a decree of the District Court of the United States, District of Massachusetts, allowing the appellees' motion to dismiss the complainant's bill, and dismissing the same, with costs.

The suit was brought by the appellant for a decree restraining the appellees, a corporation, its officers and directors, from making return of income for the year 1914 under the Income Tax Law, and from paying the income tax for said year *as computed under the authority of said law*. The action is based upon the unconstitutionality of the law in particulars hereinafter stated.

The short and undisputed facts in the case are:

The appellant is, and for many years has been, a stockholder in the appellee Baltic Mining Company (Record, page 2), a corporation of the state of Michigan (p. 1), the affairs of which are controlled by a board of directors (p. 7), who, denying the appellant's request to refrain from so doing, have voted to make and file with the Collector of Internal Revenue for the Third District of Massachusetts (where the corporation has its office and legal residence) a return of net income for the calendar year ending December 31, 1914, showing the same to be (in accordance with the requirement of the Act of Congress of October 3, 1913) the net receipts of the corporation, after deducting for depreciation only the amount of 5 per cent of the gross value, at the mine of the corporation, of its output of ore for said calendar year, and the wear and tear of the plant, machinery and equipment (pp. 9, 10).

The Baltic Mining Company owns and operates a copper mine, the known copper deposits in which, on the first day of January, 1909, as officially estimated pursuant to the regulations and instructions of the Commissioner of Internal Revenue dated February 14, 1911, were found to be 800,000,000 pounds of pure copper, worth, at their fair market value $28,000,000. This valuation was based upon an estimated life of the mine of 40 years from and after January 1, 1909, at an average rate of extraction of the ores of 20,000,000 pounds of refined copper per year during said period (p. 3).

The capital, or principal, of the investment owned by the company on January 1, 1909, was $30,000,-

000, consisting in the mineral deposits referred to and in place at the time named, and its plant, machinery and equipment, in which there was an additional investment of $2,000,000 (p. 3).

The yearly depreciation of the invested principal represented by the plant, machinery and equipment amounts to five per cent. of its value, or $100,-000 (p. 3). The yearly depreciation, or depletion, of the remaining principal, or capital, (to-wit: the mineral deposits) is measured by the amount of pure copper removed in each year. At the time of the filing of the bill, this depletion was progressing at the rate of 20,000,000 pounds of pure refined copper per year, and this will be the fair average yearly rate until the exhaustion of the ore deposits. The actual yearly depreciation of the mineral capital or principal by the removal and sale of copper ore is, therefore, one-fortieth of $28,000,000, or $700,000 (pp. 3, 6).

The gross value at the mine of the yearly output of 20,000,000 pounds of copper is $3,000,000, and the expenses of operation average 8 cents per pound, for mining, extracting, refining and selling the copper, amounting to $1,600,000 per year, leaving net receipts of $1,400,000; and these figures, as far as complainant can determine, and as he believes and charges, will continue to be the fair average figures for each year during the life of the mine (p. 3).

The highest deductible depreciation allowed by the Income Tax Law "in the case of mines" (Paragraph B, subdivision sixth, and Paragraph G, sub-

paragraph (b) (Second)), is 5 per cent, upon the gross value at the mine of the output in each year. In the case at bar, such gross value being $3,000,000, the deduction for depletion is arbitrarily limited by the law to $150,000 per year (p. 5), whereas the actual depreciation through the depletion of the mineral capital assets, or principal, of the Mining Company, by the removal of 1/40 of the entire copper deposit each year,—thereby reducing the original principal of the Company's investment of $28,000,000 in the mine by 1/40,—is $700,000. If to this be added the physical depreciation of the plant and machinery of $100,000, it will be seen that the allowance for depreciation should be $800,000 per year, leaving a taxable income of $600,000; the directors of the company, however, voted to prepare and file its return with an allowance for depreciation of $250,000 only, representing 5 per cent of the gross value at the mine of the annual output, $150,000, and the depreciation on plant, machinery and equipment, $100,000, and to pay the tax upon a net income, so computed, of $1,150,000. *As a result, $550,000 of the principal of the Mining Company will be taxed, and the tax thereon will be paid, as if said principal sum were income, unless this court intervene to prevent such unauthorized and unlawful appropriation of corporate funds.*

In the light of these facts, the appellant asserts that the Income Tax Law of October 3, 1913, is unconstitutional and void, inasmuch as—

First: It discriminates, without proper reason or qualification, against mining companies,

and in favor of all other kinds of corporations, and of all individuals, not owning mines, with respect to the kind and amount of depreciation allowed to be deducted in ascertaining net income; and thereby mining companies and their stockholders and individual mine-owners are deprived of their property without due process of law, and are also denied the equal protection of the laws, in violation of the fifth amendment.

Second: In addition to a tax upon income, it imposes a direct tax upon capital by denying to mining companies and their stockholders due allowance for actual depreciation or conversion of capital investment, in violation of Clause 3 of Section 2 of Article I of the Constitution providing that direct taxes shall be apportioned among the several states according to their respective numbers; in violation also of Clause 4 of Section 9 of Article I providing that no direct tax shall be laid by Congress unless in proportion to the census or enumeration as directed by the Constitution.

Third: It attempts unlawfully to discriminate between corporations or individuals not owning mines and companies or individuals owning mines, thereby denying to the latter the equal protection of the laws, in contravention of the fifth amendment.

Fourth: It discriminates unlawfully against mining companies and their stockholders by attempting to limit allowable depreciation (as the law is administered by the Commissioner of Internal Revenue) to a sum based on the actual cost of their mines, instead of allowing depreciation based on their fair value; thereby depriving mining companies of their property without due process of law.

Fifth: It unlawfully discriminates against mining companies and their stockholders and in favor of all other classes of corporations, by attempting to measure the tax of mining companies by their *gross receipts* while the tax of other corporations is measured by their *net income;* and further by subjecting mining com-

panies to a discriminatory method of taxation not applied to other classes of corporations, under which their tax is measured by reference to a period already expired before the adoption of the sixteenth amendment, thereby denying to mining companies the equal protection of the laws, and depriving them of their property without due process of law, in violation of the fifth amendment.

Sixth: It is grossly unfair and unequal, and denies to mining companies the equal protection of the laws and the due process of law guaranteed by the fifth amendment, in levying double taxation upon holding companies, one of which, the Copper Range Consolidated Company, owns 99 per cent of the capital stock of the Baltic Mining Company, so that the income of the Baltic Mining Company is taxed twice, first in the Baltic Mining Company, and, second, in the Copper Range Company, which is required to pay income tax upon the dividends received from the Baltic Company.

Seventh: It unlawfully discriminates between individuals and corporations in the imposition of a sur-tax upon the net incomes of individuals in excess of $20,000; thereby refusing equal protection of the laws and the due process of law guaranteed by the fifth amendment.

Eighth: It denies the equal protection of the laws and the due process of law guaranteed by the fifth amendment in exempting individual incomes below $4,000, and the incomes of labor and other organizations.

Through the courteous assent of counsel representing the appellant and the appellees, and by the indulgence of this court, the writer, representing owners of various iron-bearing properties on the Mesaba range in Minnesota whose rights and in-

terests will be directly affected by the decision of this case, has been permitted to file this brief as *amicus curiae*, and it has been prepared, and is submitted, in order that the determination of the important questions presented by this appeal may be made with knowledge of some of the conditions to which it will be applicable, and of the wide field of authority which it will embrace.

In physical characteristics iron-bearing properties differ markedly from copper properties, in that the iron deposits on the Mesaba range in Minnesota lie in flat, blanket formations, the boundaries or shores of which, and the depth and quantity of the ore content, can be determined with extraordinary accuracy by test-pits, shafts and drilling from the surface. The actual quantitative depletion of the ore-beds can therefore, when mining operations are in progress, be ascertained with precision, and the true depreciation in any tax year can be exactly stated.

Almost without exception, the iron bearing lands possess no value except for the ores contained in them. All timber has been removed long since and the soil is worthless for purposes of agriculture.

All of the iron bearing formation on the Mesaba Range has been already thoroughly explored, so that there is no opportunity for discovery of further deposits. The measure of each deposit has also been made, and there is no room for substantial additions to the tonnage upon any given government subdivision of land. In these respects the situation is radically different from that existing on

other iron ranges, and from that which is found in the copper regions and in precious metal mines.

In addition to this fact, it is also true that in any iron-ore deposit (at least on the Mesaba range) the quality of the ore varies at different depths, both as to the actual iron content and as to the proportion of the various other ingredients affecting its market worth, thus making the percentage of depletion of capital investment, through mining, a constantly fluctuating element.

As the costs of exploration and development of mineral lands are large and, in connection with the purchase of needful machinery and equipment, involve initial expenditures beyond the means of the average land owner, another feature peculiarly characteristics of Minnesota iron properties is, that a large proportion of them are operated by other parties than the owners, acting under mining contracts designated, in the greater number of cases, as mining leases. Under these contracts, the operator pays to the mine owners a specified sum per ton for ore mined and shipped, commonly called "royalty" (*Von Baumbach v. Sargent Land Co.*, 219 Fed., 39), and in most instances, in case operations are not immediately instituted, or are temporarily suspended, provision is made for the payment to the mine owners of advance royalties in accordance with a stipulated annual minimum, which royalties are applied in payment of ore subsequently removed. Such mining contracts or leases are always made for terms long enough to give ample time for the mining and ship-

ping of the entire ore deposits, and the annual minimum payments to the fee owners are equivalent to a discharge of the purchase price of the ore in installments.

Then, too, many of the iron properties are comparatively small in area or in the extent of the mineral deposits, so that, when mining operations are entered upon, the ores are exhausted in one or two or three years. A person may buy such a property after the ascertainment of its mineral content and immediately proceed to mine and ship the ores; or he may lease it to an operator who will remove the ores at once; and, unless he can replace it by the substitution of the proceeds of the ore which he mines and sells, or by the royalties which he receives under his lease, he cannot recover his invested capital.

In the case of royalties, the question will from time to time arise as to what proportion of them, if any, shall properly be assigned to income. That, however, is a question of fact in each case with which we are not now concerned, beyond the general assertion that the transaction between mine-owner and mine-operator constitutes, in effect, a *sale* of the ore in place, and that the royalty payments are to be considered as installments of purchase money,—a mere conversion of capital assets.

Gowan v. Christie, L. R., 2 H. L. (Scotch), 273, 283-4.

Coltness Iron Co. v. Black, L. R., 6 App. Cas., 315, 335.

Stoughton's Appeal, 88 Pa., 198, 201-202.

Tiley v. Moyers, 43 Pa. St., 404.
Eley's Appeal, 103 Pa. St., 300.
Fairchild v. Fairchild, 9 Atl. Rep. (Pa.), 255.
Von Baumbach v. Sargent Land Co., 219 Fed., 31, 37, 39.

From what has been said, it is manifest that, in the interpretation of the income tax law, the varying conditions attaching to mineral properties wherever situated must be taken into consideration. There may be owners who operate their own properties—and thus stand in the position of the Baltic Mining Company, the appellee in the case at bar—and derive therefrom a net income by way of mining profits. In the numerous instances, however, where the owners receive royalties for ore mined from their properties by others, they are differently situated, in that their royalties largely, if not wholly, represent merely a transmutation of their ore capital into a money capital, without mining profits. If, however, the proceeds so derived by the owner exceed the value of the mine (his invested capital), the overplus represents income—which may be taxed as income; *but that portion of the proceeds which represents the capital cannot be so taxed.*

Stevens v. Hudson's Bay Co., 101 L. T. Rep., 96.
Von Baumbach v. Sargent Land Co., 219 Fed., 31, 36-39.

It must be remembered also that mines have always been recognized as wasting properties. With every pound of ore removed, the invested capital of

the owner (whether the mine be operated by himself or by another under contract) is proportionately diminished so that in time, when all the ore is removed from a given deposit, the investment of the owner has also disappeared. The original invested capital, or value, of the mine will then have been converted into money and returned in that form to its owner. If, in any case, the royalty payments include gain or profit above the actual value of the property on March 1, 1913, such gain or profit, as has been said, is properly taxable as income. This is so clearly recognized by prudent owners of mineral properties that they sedulously set aside for reinvestment such proportion of their receipts therefrom as represents their capital returned, expending only the surplus.

The owners of the iron properties whom the writer represents, in common with the appellant in this action, believe that the Congress has not power to limit, by arbitrary rule, the amount allowable for depreciation in determining the net income of a tax payer, and that, where such arbitrary rule results in including in taxable *income* sums which represent merely *the conversion of capital assets into money*, without any ingredient of gain or profit, it imposes a direct tax upon the property of the tax payer so included, contrary to the constitutional regulation of the mode of laying direct taxes.

It is in respect especially of this aspect of the case at bar that the writer desires to submit his views to the court under the privilege which has been accorded him.

ARGUMENT.

Under the facts of the case at bar, as already recited, the interpretation, validity and application of the provisions of the Congressional Act of October 3, 1913, commonly known as the Income Tax Law, are presented to this court. Those provisions, in so far as they must be construed at this time, are as follows:

> "Paragraph 3, subdiv. 1. There shall be levied, assessed, collected and paid annually upon the entire net income arising or accruing from all sources in the preceding calendar year to every citizen of the United States, whether residing at home or abroad, and to every person residing in the United States, though not a citizen thereof, a tax of 1 per centum per annum upon such income, except as hereinafter provided; and a like tax shall be assessed, levied, collected and paid annually upon the entire net income from all property owned and from every business, trade or profession carried on in the United States by persons residing elsewhere."

By subdivision 2 the above named tax is designated as the "normal" tax.

By paragraph B, the gains, profits and income to be included by an individual tax payer are industriously defined, with a provision for the allowance of certain deductions comprised in eight distinct classes, of which the 6th is as follows:

> "Sixth. A reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business, *not to exceed, in the case of mines, 5 per centum of the gross value at the mine of the output for the year for which the computation is made.*"

As to the tax on corporate incomes, the salient provisions are the following:

"Paragraph G (a). That the normal tax hereinbefore imposed upon individuals likewise shall be levied, assessed and paid annually upon the entire net income arising or accruing from all sources during the previous calendar year to every corporation, joint stock company or association, and every insurance company, organized in the United States, no matter how created or organized, not including partnerships. * * *

(b) Such net income shall be ascertained by deducting from the gross amount of the net income of such corporation, joint stock company or association, or insurance company, received within the year from all sources,

(First) All the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties, including rentals or other payments required to be made as a condition to the continued use or possession of property;

(Second) All losses actually sustained within the year and not compensated by insurance or otherwise, including a reasonable allowance for depreciation by use, wear and tear of property, if any; *and in the case of mines a reasonable allowance for depreciation of ores and all other natural deposits, not to exceed 5 per centum of the gross value at the mine of the output for the year for which the computation is made.* * * *

(c) The tax herein imposed shall be computed upon its entire *net income* accrued within each preceding calendar year ending December thirty-first. * * *

All corporations * * * subject to the tax herein imposed, on or before the first day of March nineteen hundred and fourteen, and the first day of March in each year thereafter, * * * in such form as the Commissioner of Internal

Revenue, with the approval of the Secretary of the Treasury, shall prescribe, shall render a true and accurate return under oath or affirmation of its president, vice president, or other principal officer, and its treasurer or assistant treasurer, to the Collector of Internal Revenue for the district in which it has its principal place of business, setting forth * * *

(Third) the gross amount of its income, received during such year from all sources; * * *

(Fifth) the total amount of all losses actually sustained during the year and not compensated by insurance or otherwise, *stating separately any amounts allowed for depreciation of property;* * * *

(Eighth) *the net income* of such corporation, joint stock company or association, or insurance company, after making the deductions in this subsection authorized."

Until modified by the Sixteenth Amendment, the constitutional provisions relating to taxation by the federal government were these:

Article 1, Sec. 2, Clause 3: "Representatives and direct taxes shall be apportioned among the several states which may be included within this union, according to their respective numbers, which shall be determined by adding to the whole number of free persons, including those bound to service for a term of years and excluding Indians not taxed, three-fifths of all other persons. The actual enumeration shall be made within three years after the first meeting of the Congress of the United States, and within every subsequent term of ten years, in such manner as they shall by law direct."

(By section 2 of the Fourteenth Amendment this provision was modified so that the whole number of persons in each state should be counted, excluding only Indians not taxed.)

> Article 1, Sec. 8, Clause 1: "The Congress shall have power: to lay and collect taxes, duties, imposts and excises, to pay the debts and provide for the common defense and general welfare of the United States; but all duties, imposts and excises shall be uniform throughout the United States."
>
> Article 1, Sec. 9, Clauses 4 and 5: "No capitation, or other direct, tax shall be laid unless in proportion to the census or enumeration hereinbefore directed to be taken.
>
> "No tax or duty shall be laid on articles exported from any state."

The provisions of the constitution above quoted have been, time and again, minutely analyzed and expounded by this court and their true interpretation has been definitely fixed so far as the particular issue here presented is concerned. As a consequence, a detailed discussion of the various decisions will not be justified. Among the most important of those decisions are:

Hylton v. United States, 3 Dall., 171.

McCullough v. Maryland, 17 U. S., 316.

Brown v. Maryland, 25 U. S., 419.

Weston v. Charleston, 27 U. S., 449.

Dobbins v. Erie Co. Commissioners, 41 U. S., 435.

The License Tax Cases, 72 U. S., 462.

Society for Savings v. Coite, 73 U. S., 594.

Northern Central Ry. v. Jackson, 74 U. S., 262.

Pacific Insurance Co. v. Soule, 74 U. S., 433.

Veazie Bank v. Fenno, 75 U. S., 533.

Scholey v. Rew, 90 U. S., 331.

Cook v. Pennsylvania, 97 U. S., 566.

Springer v. United States, 102 U. S., 586.

Leloup v. Mobile, 127 U. S., 640.

Pollock v. Farmers Loan & Trust Co., 157 U. S., 429.

Pollock v. Farmers Loan & Trust Co., 158 U. S., 601.

Knowlton v. Moore, 178 U. S., 41.

In the original opinion in the *Pollock case*, 157 U. S., at page 557, *Chief Justice Fuller* said:

> "In the matter of taxation the constitution recognizes the two great classes of direct and indirect taxes, and lays down two rules by which their imposition must be governed, namely: The rule of apportionment as to direct taxes, and the rule of uniformity as to duties, imposts and excises."

It may be remarked in passing that, obviously, the requirement of apportionment as to direct taxes is not so much a limitation upon the taxing power of Congress as it is a regulation of the *mode of exercising* the unlimited power of taxation conferred by clause 1, of Sec. 8, of Article I, above quoted.

Veazie Bank v. Fenno, 75 U. S., 533, 541.

From the beginning, no doubt seems ever to have existed that direct taxes included, in addition to capitation taxes, taxes upon land. Thus, in the familiar case of *Hylton v. United States*, 3 Dallas, 171, *Mr. Justice Patterson* said (at page 176):

> "What are direct taxes within the meaning of the constitution? The constitution declares that a capitation tax is a direct tax, and both in theory and practice a tax on land is deemed to be a direct tax. In this way, the terms direct

taxes and capitation and other direct taxes are satisfied. It is not necessary to determine whether a tax on the product of land be a direct or indirect tax."

Passing over the numerous intervening decisions of this court having a more or less forceful bearing upon the construction of the constitutional provisions referred to, we find that the question left undetermined in the *Hylton case* was immediately presented in *Pollock v. Farmers' Loan & Trust Company*, 157 U. S., 429, and was there finally decided by this court, when the *Chief Justice*, speaking for a majority of the court, used this language, at page 581:

> "The real question is, is there any basis upon which to rest the contention that real estate belongs to one of the two great classes of taxes, and the rent or income which is the incident of its ownership belongs to the other. We are unable to perceive any ground for the alleged distinction. An annual tax upon the annual value or annual user of real estate appears to us the same in substance as an annual tax on real estate, which would be paid out of the rent or income. * * * If it be true that by varying the form the substance may be changed, it is not easy to see that anything would remain of the limitations of the constitution or of the rule of taxation and representation so carefully recognized and guarded in favor of the citizens of each state. But constitutional provisions cannot be thus evaded. It is the substance and not the form which controls, as has indeed been established by repeated decisions of this court."

Upon the rehearing of that famous case, a majority of the court extended the decision so as to in-

clude among direct taxes one imposed upon *personal property* and the income of personal property, the decision of the court being thus summarized by the Chief Justice (158 U. S., at page 637):

> "Our conclusions may therefore be summed up as follows:
>
> *First*: We adhere to the opinion already announced that, taxes on real estate being indisputably direct taxes, taxes on the rents or income of real estate are equally direct taxes.
>
> *Second*: We are of opinion that taxes on personal property, or on income of personal property, are likewise direct taxes."

The present *Chief Justice*, in the opinion of this court in *Knowlton v. Moore*, 178 U. S., 41, 82, said, with reference to the decision in the *Pollock case*:

> "Two things were decided by the court: first, that no sound distinction existed between a tax levied on a person solely because of his general ownership of real property, and the same tax imposed solely because of his general ownership of personal property; secondly, that the tax on the income derived from such property, real or personal, was the legal equivalent of a direct tax on the property from which such income was derived, and hence must be apportioned."

So familiar are the declarations of this court, that, without further quotation, we may recite the following among its definitive conclusions respecting the meaning of the tax clauses of the Constitution *prior to the adoption of the 16th Amendment*:

> 1. The power of taxation originally given to the Congress was unlimited; except that it could not tax exports.
>
> *The License Tax Cases*, 72 U. S., 462, 471.

Pacific Insurance Co. v. Soule, 74 U. S., 433, 446.

Veazie Bank v. Fenno, 75 U. S., 553, 540.

2. Federal taxes, under the Constitution, were divided into the two great classes of direct and indirect taxes.

Pollock v. Farmers' Loan & Trust Co., 157 U. S., 429, 557.

3. So far as the ingenuity of economists has thus far devised, all taxes fall into one of the two classes named.

Pollock v. Farmers' Loan & Trust Co., ubi supra.

4. Capitation taxes and taxes upon land have always been recognized as direct taxes.

Hylton v. United States, 3 Dall., 171.

Veazie Bank v. Fenno, 75 U. S., 533, 544.

5. Taxes upon land, being indisputably direct taxes, taxes on rents or income of land were equally direct taxes.

Pollock v. Farmers' Loan & Trust Co., 157 U. S., 581; 158 U. S., 637.

6. Taxes upon personal property, or upon the income of personal property, were likewise direct taxes.

Pollock v. Farmers' Loan & Trust Co., 158 U. S., 637.

7. The imposition of direct taxes was regulated by the rule of apportionment; and the imposition of duties, imposts and excises, was governed by the rule of uniformity.

Pollock v. Farmers' Loan & Trust Co., 157 U. S., 557.

These conclusions were acquiesced in by the Congress and were regarded as the law of the land, and it was in the light of such acepted doctrines that, on July 31, 1909, what is now the 16th Amendment to the Constitution of the United States was proposed to the legislatures of the several states, and in a proclamation by the Secretary of State dated February 25, 1913, it was declared to have received the ratification of the requisite number of states, and to have become effective as of that date. The wording of the Sixteenth Amendment is as follows:

> "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration."

The question arises then as to the effect of the 16th amendment. What was its purpose? What modifications in the conclusions above enumerated has it produced?

It is respectfully submitted: (1) That the single purpose, and sole effect, of the Amendment are to disencumber the Federal taxing power, as theretofore existing, in such manner as to allow the laying and collection of *a direct tax on incomes without apportionment and without regard to any census or enumeration.* (2) That the nature of an income tax is not changed by the Amendment, but that it still remains a *direct* tax, the mode of laying such direct tax only being modified. (3) That, as to direct taxes on all other classes of prop-

erty, the original constitutional provisions as construed by this court are still applicable and controlling. (4) If these premises be true, it follows that, in so far as the Income Tax Law attempts to impose a tax upon any property that is not strictly income, it is unauthorized by the Constitution, and must be declared void and inoperative.

The position thus outlined can be presented in very narrow limits and without the citation or examination of many authorities.

I.

THE SINGLE PURPOSE AND SOLE EFFECT OF THE AMENDMENT ARE TO DISENCUMBER THE FEDERAL TAXING POWER, AS THERETOFORE EXISTING, IN SUCH MANNER AS TO ALLOW THE LAYING OF A DIRECT TAX UPON INCOMES WITHOUT APPORTIONMENT AMONG THE SEVERAL STATES, AND WITHOUT REGARD TO ANY CENSUS OR ENUMERATION.

As has been often remarked, because an individual becomes a member of a court, he is not thereby forbidden to exercise his judgment in the light of common experience or of the knowledge acquired by exceptional aptitude or opportunity, which renders his judgment of value; nor is it to be assumed that he is ignorant either of the history of his time or of the conditions of his environment, so that he may not take judicial notice of their facts. It is not needful, therefore, in order that this court may consider the law in this case from the proper viewpoint, that the bill of complaint should set out the history of the enactment of the various Federal tax laws which have, heretofore, been the subject of adjudication, or of the law which is now presented to the court for interpretation.

Going back no farther than the Income Tax law of 1894, it is within the direct knowledge of every member of this court that its enactment was brought about by the purpose to put into operation the economic theories which had become the historical policy of the political party then in power, namely, the elimination of the distinctive principle

of the protective tariff, and the substitution of a tariff for revenue reasonably and equitably adjusted. The inclusion in the Wilson Tariff Act of 1894, of the Income Tax provisions was due to the necessity of providing an adequate revenue for governmental purposes, which, owing to the depressed commercial conditions following the panic of 1893, and to the anticipated reduction in public revenue under the import duties provided for in the bill, would otherwise be insufficient. The political revolution in 1896, brought about the early repeal of the Wilson law, and the return to the protective system which had theretofore prevailed.

During the Taft Administration, when the necessity for increased revenues was pressing, it is well known that a majority of the members of Congress belonging to the then dominant party, advocated, for a time, the enactment of a new income tax law, in the expectation that the changes in *personnel* which had occurred in the Supreme Court since the decision in the *Pollock case* would result, if the validity of the law were assailed, in a repudiation of the doctrine announced in that case and a decision that an income tax is not a direct tax. It was only by the personal intervention of the President, that this determination on the part of Congress was not carried out. Instead of enacting an income tax law, the Congress, upon the President's suggestion, passed the corporation tax law of August 5, 1909.

Thereafter, the 16th Amendment was adopted and, with the return of the Democratic Party, to

power in March, 1913, the project of embodying in the statutes its economic theory of a suitably adjusted tariff for revenue was again taken up, resulting in the enactment of the law of October 3, 1913, Section II of which is the present Federal Income Tax law.

The history of the building and adoption of the Federal Constitution demonstrates, as this court has frequently recited, that it was the manifest purpose of the founders of our Government that resort to the imposition of direct taxes by the Congress should be had only in case of extreme need, and the rule of apportionment was adopted for the protection of the smaller states and as a prevention of too frequent exercise of the power to levy direct taxes. The growing needs of the Government for revenue in these latter days have been deemed by the people a sufficient reason for relaxing, in a degree, the strict regulations in relation to the laying of direct taxes which prevailed prior to the promulgation of the 16th Amendment, and the wisdom or unwisdom of the adoption of that amendment is not open for discussion.

The effect of that amendment is to be considered in the light of these historical facts which disclose most clearly that, while the amendment let down the bars in some degree, the extent of their lowering was carefully measured and must be fully respected.

Prior to its adoption, the Congress could impose no capitation tax, no tax upon real property, and no tax upon personal property, unless in propor-

tion to a census or enumeration, and by apportionment among the several states according to their respective numbers as disclosed by the census; and a tax upon the *income* of real property, or of personal property, was subject to the same regulations.

The 16th Amendment was designed to accomplish, and in distinct terms did accomplish, the simplifying of the process of taxing *incomes* from whatever source derived, by relieving it from the hampering conditions theretofore attaching to a direct tax. Did it accomplish, or was it designed to accomplish, anything more?

By the 14th Amendment, § 2 of Article I of the Constitution had been modified as respects the persons to be included in any enumeration which should be the basis for the laying of a direct tax. This same section has now been modified for a second time by the 16th Amendment with the result that the first sentence of the section, in effect, now stands as if enacted in the following words:

> "Representatives and direct taxes shall be apportioned among the several states which which may be included within this Union, according to their respective numbers, counting the whole number of persons in each state, excluding Indians not taxed; provided, however, that the Congress shall have power to lay and collect direct taxes upon incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration."

In like manner, clause 4 of Sec. 9 of Article I, since the adoption of the 16th Amendment, must be read, in effect, as follows:

> "No capitation or other direct tax (except a tax upon incomes from whatever source derived) shall be laid unless in proportion to the census or enumeration hereinbefore directed to be taken."

Applying the ordinary canons of interpretation to the language of the 16th Amendment, it is apparent—so apparent as to exclude argument—that it can have but one meaning. The Congress already possessed, under clause 1 of Sec. 8 of Article I, *the power* to impose taxes upon incomes, but, under the provisions of Sec. 2 and Sec. 9 of the same article, the power was expressly limited to the imposition of a direct tax in accordance with the rule of apportionment. When read, as it must be, in connection with the existing tax provisions of the Constitution, the language of the amendment indicates that *it was not intended as an original grant of power to the Congress to lay and collect taxes on incomes.* That power had existed from the beginning of the government. The first clause of the amendment, therefore, which reads, "The Congress "shall have power to lay and collect taxes on in-"comes, from whatever source derived," was merely introductory to, and applicative of, the essential enactment contained in the words immediately following, to-wit: "*Without apportionment among the "several states, and without regard to any census or "enumeration.*" Theretofore, such tax could be laid and collected only by spreading it over the several states in proportion to the census or enumeration directed to be taken in Sec. 2 of Article I. The new

matter introduced into the Constitution by the amendment, and the vital end sought to be attained thereby, consisted in the enactment that taxes upon incomes might thereafter be laid and collected by Congress, "*without* apportionment among the several states, and *without* regard to any census or enumeration."

The only subject dealt with in the amendment is a tax upon incomes, and the manifest aim of the amendment was to empower Congress to lay and collect such a tax regardless of the rule of apportionment or of any census or enumeration; whereas, until its adoption, the power, although it existed, could be exerted ~~expected~~ only under the rule of apportionment and with strict regard to the last federal census or enumeration.

The language of the amendment is explicit; it demands no interpretation and suffers no construction; its meaning is unmistakable.

Paraphrasing the language of *Chief Justice Fuller,* as already quoted from the original opinion in the *Pollock case* (157 U. S., 557), it may consequently be said:

> In the matter of taxation, the Constitution recognizes the two great classes of direct and indirect taxes, and lays down *three* rules by which their imposition must be governed, namely: (1) The rule of apportionment as to all direct taxes except taxes upon incomes; (2) the rule that direct taxes upon incomes, from whatever source derived, may be laid and collected without reference to the rule of apportionment and without regard to any census or enumeration; and (3) the rule of uniformity as to duties, imposts and excises.

Prior to 1908, the constitution of the state of Wisconsin contained a single section on the general subject of taxation which read:

> "The rule of taxation shall be uniform, and taxes shall be levied upon such property as the legislature shall prescribe."

In the year 1908, the constitution was amended by adding to the section a new sentence authorizing the taxation of income, as follows:

> "Taxes may also be imposed on incomes, privileges and occupations, which taxes may be graduated and progressive, and reasonable exemptions may be provided."

As amended, the tax provisions of the Wisconsin constitution are seen to be markedly analagous to those of the Federal Constitution, in that they prescribe the rule of uniformity as to all taxes except those imposed upon incomes, privileges and occupations, and, as to those, the legislature may exercise the power of taxation in a different manner. Similarly, under the constitution of the United States, the Congress is governed as to the levying of duties, imposts and excises by the rule of unformity, but may lay taxes upon incomes without reference to the rule of apportionment or the rule of uniformity. As to other direct taxes, the power of Congress is restricted by the rule of apportionment, which, in the nature of things, would not be found in the constitution of a single state. Both constitutions, as now existing, classify incomes, for the purpose of taxation, separately from other forms of property; and, as to such other forms of property, both

prescribe rules of taxation distinct from those relating to taxes upon incomes.

In the case of *State v. Frear*, 148 Wis., 456, interpreting the constitutional amendment of 1908, the court said:

> "There can be no doubt of the proposition that income taxation of a progressive character, in addition to taxation of property, is directly authorized by the constitution of Wisconsin as amended in 1908. Words could hardly be plainer to express that idea than the words used. From them it clearly appears that taxation of property and taxation of incomes are recognized as two separate and distinct things in the state constitution. Both may be levied, and lawfully levied, because the constitution says so. However philosophical the argument may be that taxation of rents received from property is in effect taxation of the property itself, the people of Wisconsin have said that 'property' means one thing and 'income' means another; in other words, that income taxation is not property taxation, as the words are used in the constitution of Wisconsin."

And again, in *State, ex rel. Gas Co. v. Wisconsin Tax Commission*, 152 N. W. Rep., 848, 849:

> "The constitution, as amended, clearly recognizes the idea that the taxation of *property*, and the taxation of *incomes*, are two separate and distinct things. In taxes upon property the rule of taxation must be uniform, while taxes upon incomes may be graduated and progressive; but, as before stated, since the constitution has lawfully classified the subjects of taxation into that of property and incomes, the distinction must be observed by the courts, though logically both classes constitute property. The essence of the constitutional amendment authorizing income taxation is, that that

part of property constituting income shall be differently taxed from all other property."

In like manner it must be said of the explicit language of the 16th Amendment, that the tax authorized by it is to be laid upon incomes (as distinguished from other property subject to the rule of apportionment) separately and differently from all other property; and that the distinction must be observed by the courts.

It follows, then, that

The single purpose and sole effect of the 16th Amendment are to disencumber the federal taxing power as theretofore existing in respect of incomes, so as to allow the laying of a direct tax upon incomes without apportionment, and without regard to any census or enumeration.

Since we are seeking, first of all, to arrive at an accurate conclusion as to the effect of the 16th Amendment, let us proceed to consider the second proposition.

II.

The nature of an income tax is not changed by the amendment, but it still remains a direct tax.

This, too, is a postulate admitting of no argument. The Constitution recognizes only two classes of taxes, direct and indirect. A given tax must fall within one class or the other, *according to its inherent character;* no declaration of the Congress, or of the legislatures which ratified the 16th Amendment, can alter *the fact* of its character, and, since the decision in the *Pollock case,* it is futile to deny that an income tax is a direct tax.

This fact is an important and, indeed, a controlling, factor in the determination of the case at bar, for it demonstrates clearly the invalidity of the inflexible provision of the Income Tax Law limiting allowance for depreciation of mines to five per centum of the gross value at the mine of the annual output.

It is apparent that the percentage of capital depreciation must vary not only with, but in, each mineral bearing property; and where, in any tax year, the depreciation is in fact greater than five per centum of the gross value of the annual output of ore, a tax on the excess can only be valid when laid under the rule of apportionment.

A tax on such excess without apportionment, if attempted, could only be defended by the assertion that a tax upon incomes is no longer deemed a direct tax, and that the Congress can define what, for

the purposes of taxation, shall be regarded as income, so that thus the rule of apportionment may be disregarded as an immaterial consideration. But, although the restrictions upon imposing a direct tax on incomes were removed by it, the language of the Sixteenth Amendment indicates no assumption of any power, or suggestion of any purpose, to change *the nature* of the tax. The rule of apportionment must be abolished altogether, therefore, before the Congress can lay a *direct* tax upon anything except *incomes* in disregard of its requirements.

As far as any intent of the Congress which proposed the amendment, and of the states which ratified it, is concerned, only the mode of laying the tax was modified by the amendment. Hence, it may safely be asserted that, it is no longer open to question that *an income tax is, in its essence, a direct tax.*

III.

As to direct taxes on all classes of property other than incomes, the original constitutional limitations are still applicable and controlling.

This is a self-evident proposition. Since, as we have seen, the only purpose and effect of the 16th Amendment were to release *incomes* from the constitutional restrictions relating to the laying and collecting of direct taxes, it is palpable that no result was embraced in it to remove the limitations as to direct taxes upon other property.

The assertion alluded to in Point II,—that the Congress can define what, for the purposes of taxation, shall be regarded as income,—is met by the application of certain elementary principles:

> (1) No tax can be imposed without express legislation authorizing it; and, unless the intention of the legislature to lay the tax be explicitly and distinctly shown by unambiguous words, the public cannot be charged with its burden; for, if there be reasonable doubt of the intent, it will be denied.
>
> *Cooley on Taxation*, 267-8.
> *Erdman v. Martinez*, 184 U. S., 578, 583.
>
> (2) A legislative body cannot, by giving a tax a certain name, change its nature or effect.
>
> *Pollock v. Farmers Loan & Trust Co.*, 157 U. S., at pages 580-583.
> *Galveston Railway Co. v. Texas*, 210 U. S., 217, 227.
> *Choctaw Railway Co. v. Harrison*, 235 U. S., 292, 298.

(3) In determining the character of an alleged tax, its actual and practical result will be considered rather than the correctness of the theoretical or abstract ideas upon which it purports to be based.

Nicol v. Ames, 173 U. S., 509, 515.

(4) Things which are not in fact income cannot be made such by mere legislative fiat; it is beyond the power of a legislature, state or national, to include in income the capital, or principal, from which the income is derived.

State v. Frear, 148 Wis., 456, 512-13.

Stevens v. Hudson's Bay Company, 101 L. T. Rep., 96 (reported also in 5 Tax Cases, 424), at page 97.

Secretary of State for India v. Scoble, 89 L. T. Rep., 1, at page 3.

It is indisputable that, under the act of October 3, 1913, no tax can be assessed by the Commissioner of Internal Revenue except upon *incomes;* that, if, in the sum upon which the tax is computed, there shall be included any amount which is *not* actual income, such amount is necessarily principal or capital; that, if the actual depletion of natural deposits in a mine, by the removal of ore, exceed an amount represented by 5 per cent. of the gross value at the mine of the output for the year in which the computation is made, such excess cannot be income in fact, but must be capital or principal. Hence,

Any tax on property other than income is manifestly a direct tax which cannot be laid without observance of the rule of apportionment.

Therefore, the conclusion heretofore advanced is unescapable, to-wit:

IV.

In so far as the income tax law attempts to impose a tax upon anything not strictly income, it is unauthorized by the Constitution and must be declared void and inoperative.

Having thus arrived at a clear understanding respecting the nature and effect of the changes produced by the 16th Amendment, we proceed, since income is the subject of the amendment, to inquire, What is Income?

V.

What is Income?

It is to be observed that (with reference to both gross income and net income) the statute carefully employs the word "income" and not the word "receipts." This use of the word was manifestly *ex industria* and not merely fortuitous.

In the ordinary significance of the term "income," it means profits, earnings, gains, or increase, and not receipts. Thus the owner derives income in the receipt of interest due upon a bond, but, when the bond matures and is paid off with the last interest payment, the principal received is never considered as income, although it is distinctly an item of cash receipts, and would so be entered on the owner's books.

The same is true of a mortgage debt, the interest paid thereon alone being considered as income.

If real or personal property be sold under a contract permitting payment of the purchase price in installments extending over a period of time, with provisions for annual or semi-annual interest on deferred payments, such interest only is entered to the account of income, the various installments of *principal*, when paid, never being so regarded; on the contrary, they are placed to the account of capital investment, and are not chargeable with income tax.

In *Black on Income Tax*, section 32, we find this definition:

" 'Income' is defined as that gain which proceeds from labor, business, property or capital of any kind, as the produce of a farm, the rent of houses, the proceeds of professional business, the profits of commerce or of occupation, or the interest of money or stock in funds, etc.; revenue, salary, especially the annual receipts of a private person or a corporation from property. It means that which comes into or is received from any business or investment of capital without reference to the outgoing expenditures. * * *

"*We conclude, therefore, that for the purpose of an income tax a proper definition of the word 'income' would be, all that a man receives in cash during the year, except such sums as are merely capital or principal in a changed form; that is, excluding sums which are merely the proceeds of some other form of capital converted into cash.*"

In Section 34, *Mr. Black* continues:

"Both in popular and legal parlance 'income' is distinguished from 'capital' or 'principal.' Capital is the source of income. Income is the fruit of capital. Capital may be made very mobile and constantly change from one form of investment to another. Each time that it returns to the owner, it may or may not bring income with it, but it would be a misnomer to reckon the whole of such return as 'income' simply because it is so much money coming into the possession of the owner. *Out of the fund so returning there must be first deducted, in case there has been no loss, a sum sufficient to replace the capital originally invested, and the balance, if any, will be income.* Thus when money is loaned on a promissory note for one year at interest, and the note is paid at maturity, with the accumulated interest, the sum received must be proportioned between capital and interest. The receipt of so much of that sum as equals the face of the note is not a re-

ceipt of income; it is a replacement or substitution of capital; only the money received as interest constitutes income. * * * Again, a sum of money received from a railroad company in payment of damages for a part of a person's land taken by the railroad for its use is not income; it is a substituted capital."

In line with the foregoing we find the following definition in *Waring v. Mayor*, 60 Ga., 100:

> "The fact is, property is the tree, income is the fruit; labor is the tree, income the fruit; capital the tree, income the fruit. The fruit, if not consumed as fast as it ripens, will germinate from the seed which it encloses, and will produce other trees and grow into more property, but so long as it is fruit merely, and plucked to eat, and consumed in the eating, it is no tree and will produce itself no fruit."

The same court in *Mundy v. Van Hoose*, 104 Ga., 625, again emphasizes the distinction between capital and income, saying:

> "Income, as defined by Mr. Webster, is that gain which proceeds from labor, business, property, or capital of any kind—as the produce of a farm, the rent of houses, the proceeds of professional business, the profits of commerce or occupation, or the interest of money or stock in funds, etc. The definition demonstrates the distinction between capital assets and the income which they produce; the latter is the profits, product or gain derived from the use or investment of the former."

Mr. Seligman, in a volume entitled "*The Income Tax,*" says:

> "Section 5: *The meaning of income.* At the outset of such a study it is desirable to secure a clear idea of what is meant by income.

> Income is, of course, to be distinguished from mere receipts or gross revenue. * * * By income is always meant net income as opposed to gross income. In other words, from the receipts of any enterprise we must, in the first place, deduct the expenses of the enterprise—that is, the outlay incurred in securing the gross product. * * * Strictly speaking, income as contrasted with capital denotes the amount of wealth which flows in during a definite period and which is at the disposal of the owner for purposes of consumption, *so that in consuming it his capital remains unimpaired.*"

In *Wilcox v. County Commissioners*, 103 Mass., 544, under a statute of Massachusetts imposing a tax upon "income from profession, trade or employment exceeding $1,000," income was defined as follows:

> "The income from a 'profession, trade or employment,' which is taxable under our system of laws, *is an entirely different thing from the capital invested in the business or the stock of goods, in the purchase of which the whole or any part of such capital may have been expended.* The income meant by the statute is the income for the year, and is the result of the year's business. It is the net result of many combined influences; the use of the capital invested; the personal labor and services of the members of the firm; the skill and ability with which they lay in, or from time to time renew, their stock; the carefulness and good judgment with which they sell and give credit; and the foresight and address with which they hold themselves prepared for the fluctuations and contingencies affecting the general commerce and business of the country. To express it in a more summary and comprehensive form, it [income] is the *creation* of capital, industry and skill."

If income is not skill, or industry, or *capital;* if it is something created by and out of capital, and is in its essence an entirely different thing from capital invested, it is something that is acquired and possessed *in addition to* the capital.

Recognizing the validity of the foregoing reasoning, *Judge Willard*, in the case of *Von Baumbach v. Sargent Land Co.*, 207 Fed. 423, said, at page 430:

> "What does the word 'income' mean? In ordinary speech people recognize a difference between capital and income. I believe that the ordinary meaning attached to income, when it is not derived from personal exertion, is that it is something produced by capital *without impairing that capital, and which leaves the property intact, and that nothing can be called income which takes away from the property itself. If it does, then it ceases to be income and amounts to a sale of capital assets.*"

So, too, *Judge Sessions*, in the recent case of *Mitchell Brothers Company v. Doyle, Collector*, decided April 30, 1915, but not yet reported, said:

> "Income is and must be something over and above the original capital investment, plus the cost of production and sale."

This case is more fully referred to under Point VI of this brief.

In the case of *Stratton's Independence Limited v. Howbert*, 231 U. S., at page 415, *Mr. Justice Pitney* says:

> "For 'income' may be defined as gain derived from capital or labor, or from both combined."

There is no dissent, either among judges or lexicographers, as the foregoing review indicates, as to the meaning of "income." What is said by the Supreme Court of Wisconsin in the majority opinion

in the Income Tax Cases (*State v. Frear*, 148 Wis. 456) is not to the contrary. Reference has already been made (page 28 *ante*) to the amended Constitution of Wisconsin, which permitted taxation of incomes, privileges and occupations. Pursuant to that authority the legislature adopted an act by which, in the language of *Chief Justice Winslow*, "personal property taxation, for all practical purposes, becomes a thing of the past"; and thereby the legislature, in substance, "declared that the state's system of taxation shall be changed from a system of uniform taxation of property to a system which shall be a combination of two ideas, namely: Taxation of persons progressively, according to ability to pay, and taxation of real property uniformly, according to value." In Wisconsin there is no constitutional prohibition of direct taxation.

When, therefore, the Supreme Court used the language in that case quoted upon page 29 *ante*, and held that, "however philosophical the argument may "be that taxation of rents received from property "is in effect taxation of the property itself, the peo- "ple of Wisconsin have said that 'property' means "one thing and 'income' means another; in other "words, that income taxation is not property taxa- "tion, as the words are used in the Constitution of "Wisconsin," it did not intend to give a meaning to the word income different from that universally attached to it. The careful distinction of the decision in the *Pollock case*, in which the difference between the Constitution of Wisconsin and the Federal Constitution is carefully pointed out, demonstrates the

purpose of the Wisconsin court not to depart from the law as there stated by this court.

But whatever definition it may please anyone to give to the word *income*, the Congress, in the Act of October 3, 1913, not only in express terms, but by the very nature of the tax created by the law, distinctly defines the meaning of *net income*. That meaning manifestly is, that the net income on which the tax is to be paid is the excess of earnings, gains or profits accruing to the tax-payer during a tax year over and above the property (or invested principal) which he had at the beginning of the year. Read paragraph B, as to individuals, and paragraph G (b), as to corporations.

While the legislature of Wisconsin, under the amended constitution, is authorized to impose taxes upon property, incomes, privileges and occupations, with no restraint as respects taxation of persons, but with power to make it progressive, or in accordance with their ability to pay, and with the sole limitation upon taxation of real property that it must be uniform, according to value, the power of the Congress of the United States is quite differently restricted. Except as to incomes, the Congress can lay a direct tax upon any form of property only in accordance with the rule of apportionment based upon the last federal census; so that, as already stated, and as will be stated again, a direct federal tax upon any property which is not strictly income, is unauthorized and void.

As respects pecuniary returns from investments in any kind of property, it may, therefore, be ac-

curately asserted that income is that part of the net receipts of a tax payer which represents gains or profits after returning to him the full value of his principal investment from the use, disposition or transmutation of which the gain or profit results.

The case of *Stevens v. Hudson's Bay Company*. 101 L. T. Rep., 96 (reported also in 5 Tax Cases, 424), is an interesting and instructive illustration of the approval and application of this principle.

The company kept accounts of land sales separate from the accounts of its trading department. Such accounts showed that in 1903, in addition to profits from trading, the company received 177,000 pounds from land sales. The surveyor of taxes insisted that the company was liable to taxation on this sum as being profits or gains in trade. The company claimed that the moneys were not taxable; that they represented part of the capital value of land acquired by the company under its original charter of 1670, being reserved to the company under an act of 1868, whereby, in consideration of 300,000 pounds paid in money, and the right to select from time to time one-twentieth of the fertile lands resigned by it, there were surrendered to the Dominion of Canada the lands held under the original charter, and the privileges and rights of the "Governor and Company of Adventurers of England trading into Hudson Bay." Under this arrangement, the company had selected lands at different times, and had sold portions thereof to persons willing to buy, and the sums in question rep-

resented the net amount derived from such sales during the year 1903. These moneys, and others, were applied in reducing the capital of the company by 2 pounds per share.

Channell, J., decided that the money was taxable as income and the company appealed. The decision was reversed.

The *Master of the Rolls*, after reciting the above facts, said (at page 97):

> "I need not stay to observe that, if the money is otherwise liable to income tax, it cannot escape taxation by reason of its being applied to a capital purpose.
>
> "The real question is whether this money can be regarded as profits or gains derived by the company from carrying on a trade or business. In my opinion it cannot. The company was doing no more than an ordinary land owner does who is minded to sell from time to time, as purchasers offer, portions, suitable for building, of an estate which has devolved upon him from his ancestors. I am unable to attach any weight to the circumstance that large sales were made every year. This is not a case where land is, from time to time, purchased with a view of re-sale; the company are only getting rid by sale as fast as they reasonably can of land which they acquired as part of a consideration for the surrender of their charter. Channell, J., has treated it as a conclusion of law from the facts stated in the case, that the company were carrying on the trade of selling land. With great respect to the learned judge, I am unable to accept this view."

The concluding statement of the quotation is eminently true of the owners of iron properties who do not carry on mining operations, but who are only getting rid of their ore as fast as they reasonably

can by selling it under so-called mining leases for a fixed royalty price.

In the same case *Farwell, L. J.*, said (pages 97-8):

> "*It is well settled that income, not capital, is taxable under the income tax acts.* * * * *Income is not the less income for the purposes of income tax because it is produced by embarking capital in a wasting subject matter—e. g., in buying and working mines; nor, on the other hand, does an annual sum become income merely because it is paid annually. If it be in its inception, and not by adjustment and subsequent recoupment, composed partly of capital and partly of income, then the tax is chargeable only on so much as is income.* * * * The actual claim by the Crown in the present case is extravagant, for it is for the whole of the purchase money. If the company were to be treated as trading, they must at least be allowed the price paid for the land—namely, a proportionate part of the value of the area conveyed by them to the Canadian Government, less 300,000 £. paid."

Another instructive case is found in *Secretary of State for India v. Scoble*, 89 L. T. Rep., 1.

Under a contract made with a railway company, the Indian Government had power to purchase its railway, and it was agreed that the purchase money might, upon notice, be paid in the form of an "annuity" for a term of years. The purchase was afterward made by the government, which elected to pay the price in half-yearly installments for forty-nine years. The Secretary of State for India deducted an income tax on the full amount of the first two payments, and Scoble and others sued to recover the sums so withheld.

It was decided that the payments were not annuities or annual payments within the meaning of the acts imposing a tax "for and in respect of all profits arising from interest, annuities, dividends, and shares of annuities payable out of any public revenue."

Lord Halsbury, giving judgment, said (at page 3):

> *"Was it the intention of the income tax acts ever to tax capital as if it was income? I think it cannot be done, both upon the language of the Act itself, and upon the whole import and meaning of the income tax acts, and that it never was intended to tax capital, at all events as income.* * * * And I cannot disagree with what all the three learned judges of the Court of Appeals pointed out, that you start upon the inquiry into the matter with the fact of an antecedent debt which has got to be paid; and if these sums, which it cannot be denied are partly in liquidation of that debt which is due, are to be taxed as if they were income in each year in which the payment is being exacted, *the result is that you are taxing part of the capital."*

The application of this statement to the case of mine owners is obvious. The disposition of ore by a fee-owner who is not operating the mine is, under the system of royalty payments, merely a sale for an agreed price, payable in installments.

> *Von Baumbach v. Sargent Land Co.*, 219 Fed., 31, and cases cited.

The agreed purchase price is simply a debt, which has got to be paid, owing to the owner of the ore land. As his ore is depleted by removal, the capital

represented by it is converted into, and replaced by, the money received in royalties. *An "income tax" upon any part of the money so representing capital is necessarily a tax upon capital;* and the Congress is just as powerless to lay such a tax, by the device of limiting arbitrarily the amount of cash receipts which may be considered depletion of capital, and by assessing the remainder as income, as it is powerless to impose the tax in direct terms upon the same money under the name of capital.

Let us illustrate this by referring again to the case of Minnesota iron mines. Explored iron bearing properties are frequently bought and sold on the basis of their ascertained mineral contents. The ore deposits upon some of them are enormous in extent, but many deposits are relatively small in quantity so that they are exhausted after two or three years of mining operations. The value in place of the ore is largely influenced by the number of years which will be required to mine and remove the deposit; the longer the period required, the smaller, of course, the present value.

Suppose a person to be the owner, on the 31st day of December, 1912, of such a property, which may have cost him $50,000 one year or ten years previously, and which explorations have shown to contain a million tons of merchantable iron ore, valued in place, on December 31, 1912, at $250,000. Regardless of the original cost to him, the owner manifestly has in that property, on that day, an asset equal to the sum named. Can the enactment of the Income Tax Law of October 3, 1913, destroy that

pre-existing asset? Had Congress the power, after December 31, 1912, validly to declare that only one-fifth of it is capital, because that is all that it cost, and that the other four-fifths are income?

Again, suppose that the property was sold in January, 1913, to a purchaser, for the full value of $250,000, paid in cash, and that the purchase money was at once invested by the seller in bank stocks; can the Congress say to the seller thereafter, "Only one-fifth of your bank stocks is capital, and the remaining four-fifths is to be deemed and taxed as income?" Yet, is the $250,000 any the less invested principal when in the mine than it is in the form of bank stocks? Further, can there be any question but that, in the hands of the *purchaser* for full value, the mine represents capital? Yet where is the difference between the buyer and seller in this regard? If the mine have an intrinsic value of $250,000 at the moment of the sale, and is a capital investment in that amount of the purchaser, it must likewise have been a capital investment in the same amount of the seller, the moment before the sale.

If the owner should operate the mine and exhaust the ore in three years, taking out one-third of the deposit in each year, where would his investment be at the end of that period unless he could appropriate to principal, out of the proceeds of each year's ore sales, one-third of $250,000?

And see *Mitchell Brothers Company v. Doyle, Collector*, quoted under Point VI, *post*.

> "If it be true that, by varying the form, the substance may be changed, it is not easy to see

that anything would remain of the limitations of the constitution, or of the rule of taxation and representation so carefully recognized and guarded in favor of the citizens of each state. But constitutional provisions cannot be thus evaded. It is the substance and not the form which controls."

Per *Fuller, C. J.*, 157 U. S., 581.

By "varying the form," reference is to be understood to the imposition, attempted in the Act of 1894, of an income tax upon *rents and incomes* from real property, as distinguished from the real property itself. But while the court was unable to perceive any ground for the alleged distinction in that instance, it is now urged to hold that Congress can declare that the avails of real property, when sold, shall, over and above a fixed and arbitrary percentage of the selling price, be deemed, for tax purposes, income and not principal.

Though the *form* be changed by transmutation of ore in the mine into money, the *substance*, the invested principal, still persists, and, for tax purposes, remains unchanged. And herein lies the distinct and inevitable violation of the Constitution of which the appellant complains, in that the avails of all other sales of property, real or personal, are, so far as they represent the invested capital of the owner (and not gains or profits), wholly exempt from return or from taxation as income, whereas, in the single case of mines, it is enacted "that not to "exceed five per centum of the gross value at the "mine of the output for the year for which the com-"putation is made" shall be allowed for deprecia-

tion of capital investment. So much of the capital included in the net income of mining corporations as exceeds said five per centum is thus directly taxed in defiance of the requirement of apportionment, and thereby, to the extent of the tax exacted, private property is taken without due process of law, and appropriated to public use without just compensation.

The case of *Commonwealth v. Central Transportation Company*, 145 Pa. St., 80, was similar to the *Hudson's Bay Company case* cited. The transportation company, whose capital was represented by sleeping cars, patents for their manufacture, and contracts with railroad companies for their use, transferred the whole to another company in consideration of an annual rental, which for a time was distributed to its stockholders when received. Later it was deemed advisable to set apart a portion of the annual receipts to provide a fund to enable the company to resume its original operations if needful. This was done for several years, when it was decided to reduce the capital stock by $12 per share, and to pay the stockholders $12 for each share out of the fund thus accumulated. It was held that such distribution was not a division of annual income or profits, but a distribution of capital assets, and that the company was not, therefore, taxable on the basis of a declaration of a dividend. The decision appealed from was affirmed upon the opinion of the lower court, from which we quote:

"This case presents one question only, viz: whether the sum of $12.00 per share paid to the defendant's stockholders in 1887 was a dividend or a reduction of capital stock; and this is as much a question of fact as of law. We have already found as a fact that the transaction complained of was not the declaration of a dividend, but a reduction of capital stock; and, if this finding is supported by the evidence, little more need be said. It is not necessary to repeat the facts above set out. There is no contradiction in the testimony, and we do not see how it is possible to reach the conclusion that a dividend, in the sense given to that word by our statutes and decisions, was either declared or intended to be declared. The fund in question plainly represented capital, was expressly divided as capital. It is true that it was sometimes loosely spoken of as a 'surplus' and the reduction as a 'dividend'; but the transaction is to be regarded as it really was and not as it may have been incorrectly named. It's truth and substance were as we have found above, and further discussion would not make the subject plainer."

By the language of the income tax law, the allowance for deduction "in the case of mines" is *not to exceed* 5 per centum of the gross value at the mine of the output for the tax year. If, in any case, it be less than 5 per centum of such value, of course, only the actual depletion can be deducted. By the same reasoning, if it be greater than 5 per centum, the true amount must be allowed.

It can scarcely be denied, if the Congress have power, by its mere declaration in a taxing law, to place bounds upon the amount of a tax payer's receipts which can be regarded as converted principal, that, in the act of 1913, it could have limited

the amount of allowable deduction to one-half of one per cent. instead of five per cent. And if that could competently be done, it means that it would be competent to declare that *all* net receipts from sales of ore, or from the operation of mines, are income.

It is possibly true that, in some extreme case, a deduction of five per cent of the gross value at the mouth of the mine of the yearly output might be sufficient to cover the value of the capital converted; but it is not probable that such a case will ever be disclosed. Considered from every standpoint, it is obvious that no fixed proportion can be established which will accurately determine the allowance to be made in every instance.

> "In the application of this tax act to the numberless and varied situations which different cases present, the actual facts of each case and the real consequences must be considered and given legitimate effect, regardless of misleading names and forms."
>
> *Von Baumbach v. Sargent Land Co.*, 219 Fed., at page 38.

It may be said further that if, in the case of mines, the Congress have power to fix, by an inflexible regulation, the percentage of actual receipts therefrom which may represent the conversion of invested capital, it can, by a similar inflexible regulation, determine the deductible proportion of annual receipts *from every other source;* and, by parity of reasoning, can determine arbitrarily the amount of tax which shall be paid *as upon income,* regardless of the actual income.

In respect of income taxes, it has been observed that "the fundamental idea upon which its cham- "pions rest their argument in its favor is that tax- "ation should logically be imposed according to "ability to pay, rather than upon the mere posses- "sion of property, which, for various reasons, may "produce no revenue to the owner."

State v. Frear, 148 Wis., 456, 505.

See also *Knowlton v. Moore,* 178 U. S., 41, 109.

This principle, when applied to the Income Tax Law of 1913, demonstrates clearly the correctness of the appellant's position. In considering an income tax law, there is obviously no relation whatever between gross receipts and ability to pay. True ability to pay relates to, and is dependent upon, *net income.* If a business, no matter how great its volume, be carried on at a loss, there is no net income and neither ability nor liability to pay an income tax. The ownership of unproductive property, no matter how valuable it may be, may bring it about that the owner's burden of interest and tax charges may exceed his gross receipts, however large; in such case, he is exempt from income taxes. If a tax payer have a principal of $50,000 invested in government 3 per cent bonds, his ability to pay is measured by the income of $1,500 derived therefrom; if his neighbor have a principal of $50,000 invested in farm mortgages returning an income of 6 per cent., his ability to pay is measured by the income of $3,000 so accruing; if both of them dispose of their principal at par, their ability to pay is not—merely because they have received $50,000

in cash through such disposition—the same as that of the man whose principal is large enough, and so invested, that, during the same year, he receives therefrom an income of $50,000. The Act of October 3, 1913, in unescapable terms, limits the imposition of taxes thereunder to the *net* income, which of itself imperatively excludes from consideration and taxation any other part of gross receipts and, *a fortiori*, any portion of capital or principal. If it were in the mind of Congress to embrace anything else, such purpose would be palpably futile, in that it would instantly come into conflict with the rule of apportionment.

The property of an individual or a corporation represents his or its capital. In the case of a corporation, it measures its capital investment regardless of the amount of its authorized capital or of the outstanding certificates of capital stock. Shares of stock evidence simply ownership of fractional parts of the corporate assets represented by its property, and its actual value may be vastly greater or vastly smaller than its face value. If the corporate property be converted into cash, the proceeds are still the capital of the corporation, and, if such proceeds be divided among the shareholders, the distribution is one of capital and not of gains or profits. If the entire assets be thus distributed, the certificates of stock, which before the distribution had a value, at once become worthless, so far as tangible assets are concerned.

Equally so, if the property of an individual be converted into cash, the proceeds still constitute

his capital, or investment principal.

Apply this to mine owners.

(a) In the case of owners of mines who are also operating them, the *net receipts* from sale of ore are made up of two elements; one, the profit from mining; the other, the moneys representing the conversion of capital from ore into money, the propriety of a deduction for which, in arriving at the *net income*, is expressly recognized by the act. If the conversion of capital exceed 5 per centum of the gross value at the mine of the yearly output, then it is plain that a portion of the capital will, under the terms of the law permitting a deduction of 5% only, be taxed as income.

(b) In the case of owners whose mines are operated by others, under a contract of sale or lease, it is too clear to admit discussion that some portion (if not all) of the royalties received must represent the value of the ore in place, and, so, is converted capital.

In both cases it follows, of necessity, that only so much of the receipts, or royalties (as the case may be), which are in excess of the capital investment included in them is income which can be considered in assessing an income tax; and it was for this reason that allowance for depletion of capital was expressly provided for in the act.

In the *Howbert case,* 231 U. S., 399, arising under the Corporation Tax Law, this court specifically recognized that, even in the case of a mining cor-

poration operating its own property, an allowance for depreciation must be made when properly ascertained. Under that law, a corporation was authorized to deduct from the gross income, "all losses actually sustained within the year and not compensated by insurance or otherwise, including a reasonable allowance for depreciation of property, if any."

The court said, at pages 417-18:

> "Congress no doubt contemplated that such corporations, amongst others, were doing business with a wasting capital, and for such wastage they made due provision in declaring that from the gross income there should be deducted (*inter alia*) 'all losses actually sustained within the year,' including 'reasonable allowance for depreciation of property, if any,' etc."

Again, at page 421, we find this language:

> "It was, of course, contemplated that income might be derived from the employment of property in business, and that this property might become more or less exhausted in the process; and because of this, a reasonable allowance was to be made for depreciation of it, if any."

That case came to this court on a certificate from the Circuit Court of Appeals of the Eighth Circuit.

An analysis of the opinion of *Mr. Justice Pitney* (which denied the right of the plaintiff in error, the Mining Company, to depreciation *under the stipulated facts in the case*) discloses that the decision cannot be taken, and was not intended to be taken, as one of general application, but was confined to the particular case, leaving open for further consideration by the Supreme Court the question of what allowance for depletion shall prop-

erly be made to a Mining Company operating its own property. Rarely is a decision seen in which so great care is taken not to seem to set a precedent; the court industriously limited its decision to the facts before it and to the special cause in which they appeared.

It will also be noted that, in the *Howbert case* (at page 414), this court adopted the view which is now advanced in behalf of the appellant, when it declared that the sale outright of a mining property "might be fairly described as a mere conversion of the capital from land into money." Such conversion does not depend upon the terms of payment; it will result quite as absolutely when the purchase price is payable at agreed intervals as when it is paid in full at the time of the transaction. That a sale of ore, therefore, under a mining contract which provides for payment, either in the form of annual minimum royalties or in the form of royalties to be paid only when ore is actually mined and shipped, results in a "conversion of capital from land into money" cannot well be controverted.

The case of *Foley v. Fletcher*, 3 H. & N., 769, has a direct bearing upon the application of the Income Tax Law to the owners of mining properties which are operated by other parties under contract (as in the case of a majority of the Minnesota iron mines). It disposes of the erroneous conception that postponement of payment of the consideration for ore sold by mine owners under royalty contracts is a fact of importance in determining the charac-

ter of the payments as being capital or income, and it very conclusively shows that they are not the latter.

The plaintiff in the case cited, being the owner of an undivided one-half of an estate containing coal mines, joined with her co-tenant in a sale thereof to defendants, the contract providing that her portion of the purchase price should be paid in semi-annual installments extending over a period of thirty years. The defendants retained certain sums as income tax deductible at the source, under the law imposing such tax upon "all annuities, yearly interest of moneys, or other annual payments."

Pollock, C. B., held that such deductions were not authorized, using these words (at page 778):

> "The question is whether, on the sale of an estate which professes to be for 99,000 *l.*, of which a part is paid down and part paid by installments, extending over a long period of years, such installments are to be considered as an annuity or annual payment, and liable to income tax."

He then adverted to the contentions of defendants: (1) that the payments were profits because, when the protracted period of payment was considered, it could not be assumed that the value of plaintiff's estate was in excess of about one-half the amount agreed to be paid to her, and that the rest must be considered as profit; (2) that it was the fault of the plaintiff that she had so mixed the profits and capital that they could not be distinguished, and that therefore the whole must be liable to income tax—and said (at pages 778, 780):

"But there is nothing on this record to show that the property was not worth more than 99,000 *l.*; nor is there anything to show that the postponement of payment was not a mere indulgence on the part of the seller. But if we were at liberty to speculate on the matter, and could come to the conclusion that part of the annual payments is the price of the convenience of getting the payment postponed, we could not say that the payments were within the act because a part of them consists of profits. *These installments are payments of money due as capital;* the act made no provision for such a case. It professes to charge profits only and we cannot say that capital is liable because found in company with profits. If payments such as those in the present case are subject to income tax, wherever any debt of any sort is to be repaid by annual payments, or by installments at three or six months, it would be subject to income tax. * * *

"If Mr. Phipson (counsel for defendants) is right, the tax would attach on promissory notes payable by installments. * * * If the plaintiff had sold her estate for an annuity, so calling it, the annuity would have been liable to income tax. But she has sold it for a sum which is payable by installments, which is therefore not chargeable; and the defendants had no right under the 40th section to deduct the income tax."

Bramwell, B., concurring, said (pages 782, 783):

"By 'An act granting to her Majesty duties on profits arising from property, professions, trade and offices' *it cannot be taken that the legislature meant to impose a duty on that which is not profit derived from property, but the price of it.* * * * Mr. Phipson's argument would show that it would be reasonable [that] the payment should be divided into two parts, principal and interest. Acting on the principle that the affirmative of the proposi-

tion must be made out by those who seek to impose the tax, I cannot say that such affirmative has been established to my satisfaction."

Another concurring opinion was delivered by *Baron Watson*, who said (at pages 784, 785):

> "It is a startling proposition that income tax attaches upon debts payable by installments. It is a tax upon income; the title of the act shows it; and, reading schedules A. B. C, D, and E, it is obviously a yearly tax on what is called throughout income, and profits and gains. * * * An annuity means where income is purchased with a sum of money and the capital has gone and has ceased to exist, the principal having been converted into an annuity.
>
> Take the case of a will giving to a legatee money payable by installments; as, for instance, 10,000 *l.*, 5,000 *l.* payable at the end of the first, and 5,000 *l.* at the end of the second year after the testator's death. The sums so bequeathed would not be an annuity, and would be chargeable, not as income, but under the legacy or succession duty acts. * * * But there is not a word in the act that leads to the inference that a debt payable by installments is chargeable with income tax; and moreover a tax cannot be imposed by implication. The same question might have arisen if it had been agreed that payment to the plaintiff should be made by two installments. It is impossible to suppose that income tax cou'd attach in such a case, it being a tax upon income and not upon capital. Then again it is said that these payments are compounded of interest and principal. Possibly profit is obtained by the postponement of the payment, but the court cannot say that any part of it is interest."

The case of *Von Baumbach v. Sargent Land Company*, recently decided by the Circuit Court of

Appeals for the Eighth Circuit, in an opinion written by *Judge Sanborn,* and reported in 219 Federal Reporter, page 31, is illuminating on the question under discussion.

Three actions were brought by three land companies to recover from Von Baumbach, as the United States Collector of Internal Revenue for the District of Minnesota, the amount of taxes required to be paid by the Land Companies under the Corporation Tax Law. The cases were tried and decided together. The writer is unable to perceive any substantial distinction between the principles of law which were applied to the decision of that case and those which must govern the determination of the suit at bar. Under the Corporation Tax Law, every corporation organized for profit and having capital stock represented by shares was required to pay an annual excise tax equivalent in amount to 1% of its net income above $5,000. By the terms of the law, such net income was ascertained for the purposes of the tax in a manner not materially different from the mode prescribed for such ascertainment by the Income Tax Law. The vital question in the *Von Baumbach* case was, *What was the net income of the respective Land Companies?* Each Company was the owner of iron lands in Minnesota, which, prior to the adoption of the Act of August 5, 1909, had been "leased" to certain mining companies, and, under the terms of the so-called mining leases, fixed royalties were to be paid to the Land Companies for every ton of ore mined and shipped from its premises, and if, in

any year, sufficient ore were not mined and shipped to produce royalties amounting to the fixed minimum, or if, in any year, no ore at all were mined, the operating companies were obligated to pay advance royalties sufficient to bring the annual payment to the Land Companies up to the minimum, such payments to be applied upon ore subsequently mined.

It was claimed by the Government that the royalties received by the Land Companies, under their respective mining leases, constituted income which, reduced by the insignificant deductions permitted by the law (other than an allowance for depletion), constituted the measure of the corporation tax which must be paid by them.

The Land Companies insisted, on the other hand, that the amounts received under the mining leases by way of royalties, or advance royalties, constituted the purchase price of the ores which the operating companies were permitted to remove from the leased premises; such royalties represented the actual value of the ores at the time the tax law went into effect, and, when received by the Land Companies, they were, in fact, a substitute for the ore sold, and that thereby a conversion of the invested capital of the companies was effected from ore into money. As a consequence, it was claimed that such money could not be considered in measuring the liability of the companies to pay the corporation excise tax.

The case was heard in the District Court by *Judge Willard,* whose opinion is reported in 207

Federal, 423. The contention of the Land Companies was sustained. Upon appeal to the Circuit Court of Appeals, this decision was affirmed in an opinion which merits careful attention.

Judge Willard, in the court below, reached his conclusion, in part, by the following reasoning:

> "The word 'depreciation' and what it means in this act are to my mind not vitally important here. I do not base my decision upon the meaning of that word, nor upon its use in the act, but rather upon the meaning which should be given to the words 'gross income.' Those are the words used in the act, together with the words 'net income' and 'earnings,' the words 'gross receipts' were not used in this act, as they were in the case of the *Spreckles Sugar Refining Co. v. McLain,* 192 U. S. 397, Nor are the words used here 'deposits' as was the word used in *Society for Savings v. Coite,* 6 Wall. 594. What was intended by the use of the words 'gross income?' What does the word 'income' mean? In ordinary speech people recognize a difference between capital and income. *I believe that the ordinary meaning attached to income, when it is not derived from personal exertion, is that it is something produced by capital without impairing that capital, and which leaves the property intact, and that nothing can be called income for the purpose of this act, which takes away from the property itself If it does, then it ceases to be income, and amounts to a sale of capital assets.* This definition of the word income I think is deductible from what was said in *Flint v. Stone Tracy Company,* although it is not so distinctly stated. On page 146 of 220 U. S., the court said: 'The income is not limited to such as is received from property used in the business, strictly speaking.'
>
> That necessarily means that the property itself remains in the business, and continues

to be used in the business, and that income was something that was derived from the use of it, leaving the property intact * * * (207 Fed., at page 430).

That ore in place is capital, and is part of the real estate, I think admits of no question. It is just as much a part of the real estate as trees standing on the land.

Let us suppose that John S. Pillsbury & Company, when it owned this land with the timber still standing thereon was a corporation; that in 1908, it sold the timber with the privilege of removing it within ten years, and that in 1909, 1910, and 1911, the purchaser cut the timber and during these years paid the purchase price of it. Could it be said that the purchase price so received was income within the meaning of this act? I do not think that it could. It was not income, it was the property itself; and, as I said before, the trees standing on the land are no more a part of the realty than is the ore under the surface of the land. They are both capital, and money derived from a sale thereof cannot be considered income, whether it be money received from the ore, or money received from the timber" (p. 432).

As to what constitutes income, *Judge Sanborn* said, in the same case, when it reached the Court of Appeals, (219 Fed., at page 36):

"That the word 'income' in this act is not synonymous with the word 'receipts' from the conversion without gain or profit of any part of the property of the corporation into money, or into any other form, is demonstrated by the fact that this word 'income' appears in the clause 'the gross amount of the income of such corporation,' and segregates and designates a specific part, and not all, of the receiptsof the corporation as the basis of the measure of the tax, by the fact that only those expenses paid out of the income, none of those paid out of

capital or property, are to be deducted, by the fact that a deduction for depreciation of property is to be made, by the evident purpose and the whole tenor of the act. This word 'income' is used throughout the statute in contradistinction to 'property' or 'invested capital,' and it was neither the intention of the Congress nor is it the legal effect of the act to impose any tax on account of the amounts received by a corporation that is not engaged in the business of buying, selling, or trading in property, from the conversion of its property without gain into money or into any other form."

At page 37, he inquires:

"But were the royalties which had been owing to these corporations by the lessees since 1906, and which these corporations collected and received in 1909, 1910, and 1911, as they fell due, income by the amount of which the taxes upon them must be measured under the tax act, or were they the mere proceeds of the conversion, without gain or profit, of parts of their property into money, and no part of the measure of their lawful tax? * * * If they had sold these claims in 1909 for cash for their actual value, no part of that cash could have been gain, profit, or income. It could not have escaped being a mere different form of their property, of their capital, and the corporations could not have been taxable on account of it."

Again at page 39:

"But the truth is that the leases merely changed the form of the property of the lessors from the ores to the rights and claims to the purchase price of the ores which the lessees promised to pay under the name of 'royalties,' and the receipts by the corporation of the payments of the parts of those claims which fell due in 1909, 1910, and 1911, were but another substitution of the cash received for the parts of the claims paid. If the sums paid were gain,

> profit, or income, they might have been withdrawn and expended by the corporations without diminishing the value or amount of their property; but the claims are in fact diminished in amount and value by the amounts paid on them, and the property of the corporations is depreciated by the same amounts, unless the moneys so paid are substituted for the parts of the claims paid and remain the property of the corporations."

The court then considered that, if there were error this conclusion, and that the royalties were not a part of the converted capital investment of the Land Companies but should be deemed, for the purpose of arriving at a measure of the tax, as gross income, "then the companies would have been en-"titled to a reasonable allowance for depreciation "of property by the reduction of the values of their "claims by these payments. *Stratton's Independ-"ence Ltd. v. Howbert*, 231 U. S. 399. And as the "payments on these claims unavoidedly reduced and "depreciated their value, as has been shown, by the "amounts paid, there would have been no net in-"come from them on account of which excise taxes "could have been lawfully exacted."

Mitchell Brothers Company v. Doyle, Collector, supra.

The decision in *U. S. v. Nipissing Mining Company*, 202 Federal, 803, is in full accord with the conclusion of *Judge Sanborn*, on the subject of depreciation.

The decision in the *Von Baumbach case*, if correct, is necessarily controlling here. It is true that

the law under consideration there was the Corporation Tax Law of 1909, and that this court distinctly declared (in *Flint v. Stone-Tracy Company*, 220 U. S., 107), that it was not an income tax law, as was contended by those who attacked its validity. But under it, the *net income* of the corporation tax-payer was the basis of determining the tax, just as, under the act of 1913, the net income of the tax-payer is the basis of determining the tax. While this court decided that the corporation tax was merely an excise upon the right to do business as a corporation and that the net income was not the subject, but simply the measure, of the tax, yet, no tax could be assessed until the net income had been accurately ascertained and found to exceed $5,000 and, when a net income taxable in amount was disclosed, 1% of it determined the amount of the excise tax. Under the income tax law of 1913, the same ascertainment of net income must be made and its amount is arrived at in precisely the same manner. The same question of *What Is Income?* must be asked, and it must be answered in the one case as in the other. This is recognized in *U. S. Glue Company v. Town of Oak Creek*, 153 N. W. (Wis.), 241, where the Supreme Court of Wisconsin said, page 245:

> "The income tax is in effect not unlike the tax which was imposed upon corporations under the act of Congress in the Tariff act of 1909, and known as the 'corporation tax.' "

Hence, if the answer in the *Sargent Land Company case* were based upon correct principles of law, that answer and those principles inevitably dispose

of the same query under the Income Tax Law.

This is easily illustrated by assuming the situation (which, indeed, was for a time advocated during the formative period of the Income Tax Law) of a retention of the excise tax as respects corporations, and by adding to it provisions for the imposition of an income tax as respects individuals. As to both classes of tax payers, under such a law, the same initial step of ascertaining the net income would be essential. When ascertained, that of the corporation would be the measure of its excise tax which would be determined by taking 1% of its net income. On the other hand, the net income of the individual would be the subject of the tax, and the amount of the assesment would be determined by taking 1% of it.

Or, take another case, where an income tax is imposed upon all individuals, and, in addition, an occupation tax, to be measured by the net income derived from a particular calling, is laid upon those individuals who pursue that calling. Under such a law, one engaged in the specified business would be subject to both taxes. If, in a given case, the entire income of a man were that which he derived from a taxable calling, would there be two calculations of his income—one for computing his income tax and one for ascertaining his excise tax? Could it be contended that any different method of ascertaining the concrete fact of what his net income is would be employed in arriving at the basis of one assessment than would be employed in arriving at the basis of the other?

The *fact* as to the true amount of net income is a mathematical one, and no legislation can alter the cold fact. It is true that certain deductions and exemptions may, in the discretion of the legislature, be permitted which, in the absence of such legislation, would not otherwise be recognized in calculating net income; and it may be competent, perhaps, for the legislature to permit such deductions or exemptions in one case and not in another; but that does not impeach the accuracy of the contention.

In every case, net income must be ascertained by taking the gross income of the tax payer, whether corporate or individual, and subtracting therefrom the allowable items of expense and exemption. If royalties received for ores be a part of that gross income in one instance, they are in every other. Their nature cannot be changed by legislative declaration to suit the whims or the purposes of legislators; it is inherent and essential. If, under the corporation tax law, royalties are merely a conversion of capital investment, and are not income, they must be the same under the Income Tax Law; if they are property which the Constitution protects from confiscation under one law, they are equally safe, by virtue of its provisions, from spoliation under another law.

It is accordingly submitted that the rule adopted in the decision of the *Von Baumbach cases* is correct, and must be decisive under the Income Tax Law.

As has been observed, the power granted by the Constitution to Congress to impose taxes (save that "no tax or duty shall be laid on any articles exported from any state") is unlimited as respects the objects upon which it is operative. Subject to the one restriction, nothing taxable is excepted, of property, of occupation, of right or of privilege. As has also been mentioned, the mode of exercise of the power was, until the adoption of the 16th Amendment, regulated by the two rules already mentioned, namely: The rule of apportionment as to direct taxes, and, as to duties, imposts and excises, the rule of uniformity. The 16th Amendment introduced a *third rule,* applicable exclusively to incomes, whereby a direct tax may be laid upon incomes without apportionment among the several states, and without regard to any census or enumeration, and, as well, without any express requirement of uniformity. Uniformity, however, is an essential and inherent element of any valid tax. The essence of every taxing power is the collection of money from the people for *public* purposes only, and any attempt to extort money from a property owner for another purpose, under the guise of taxation, would not be countenanced or permitted by the courts upon general principles, irrespective of constitutional prohibition. Hence, if, under the form of a tax law, the property of an individual be taken by government for the promotion or accomplishment of an end not public in character, it would not be an exercise of the taxing power at all, but an exercise of the right of emi-

nent domain, which when lawfully employed, requires payment to the individual of just compensation. Without such compensation, the taking is confiscation, and falls within the prohibition of the Fifth Amendment. It is equally confiscation, if the property of an individual be taken by government, under the guise of a tax, by an *ultra vires* method, although for public use.

Thus in *Gordon v. Cornes*, 47 N. Y. 608, 612, the court said:

> "It would be going too far to deny that the provisions of the Constitution which declare that no person shall be deprived of property without due process of law, and that private property shall not be taken for public use without just compensation, would afford protection to the citizen against impositions *made nominally in the form of taxes*, but which were, in fact, forced levies upon individuals, or confiscation of private property, as, for instance, if the general expense of the government of the state, or of one of its municipal divisions, should be levied upon the property of an individual, or set of individuals, or perhaps upon a particular district."

The case of *Delaware etc. Ry. Co. v. Pennsylvania*, 198 U. S., 341, is in point, where the court held that the inclusion, in the valuation of the capital stock of a corporation for the purposes of taxation made by the state of Pennsylvania, of coal situated in other states deprived the corporation of its property without due process of law. It was there said (pp. 353-4):

> "This court has also frequently held that a tax on the value of the capital stock of a corporation is a tax on the property in which

> that capital was invested, and that, in consequence, *no tax can thus be levied which includes property which is otherwise exempt.*"

While the facts in that case are quite different from those here presented, the principle there applied is effective here. It is incompetent for Congress, in evaluating the net income of a tax payer for the purpose of taxation, to include therein property which is *not* income *and which is exempt by constitutional provision from such taxation.*

It was urged by the State, in the case last cited, that the tax upon the capital stock was not a direct tax upon coal situated outside of the State. To that argument, however, this court returned the following answer (p. 356):

> "We regard this tax as, in substance and fact, though not in form, a tax specifically levied upon the property of the corporation, and part of that property is outside and beyond the jurisdiction of the state which thus assumes to tax it. * * *
>
> We cannot see the distinction, so far as the question now before the court is concerned, between a tax assessed upon property *eo nomine*, or specifically, when outside the state, and a tax assessed against the corporation upon the value of its capital stock, to the extent of the value of such property, and which stock represents, to that extent, that very property. If the property itself could not be specifically taxed because outside the jurisdiction of the state, how does the tax become legal by providing for assessing the tax on the value of the capital stock to the extent it represents that property, and from which the stock obtains its increased value? Can the mere name of the taxes alter its nature in such case?"

It is clear that no property besides incomes can be taxed under the act of October 3, 1913, because it is outside the jurisdiction of the Congress to reach anything but incomes by the method there prescribed, and the tax cannot become legal by the expedient of declaring that such extra-jurisdictional property shall be considered income when it is not. The mere name cannot alter its nature in such case.

The opinion proceeds, at page 359:

> "The next question is whether there is a right to relief in a case like this founded upon the provisions of the federal constitution. We think there is. The collection of a tax under such circumstances would amount to the taking of property without due process of law, the citizen is protected from such taking by the Fourteenth Amendment."

See also, *Louisville etc. Ferry Co. v. Kentucky*, 188 U. S., 385.

The situation presented by the 16th Amendment may be thus summed up:

1. Income is the gain or profit derived from labor, or from property, or from both, and, if from property, it can only be that which is produced by its use without impairing the capital investment and which leaves such investment intact.
2. Gains, profits and income are property which, before the adoption of the 16th Amendment, could not be taxed except in accordance with the rule of apportionment, because an income tax is a direct tax.
3. The 16th Amendment does not change the nature of an income tax; it still remains a direct tax.
4. By the 16th Amendment, however, a new rule is introduced into the Constitution where-

by a direct tax may now be assessed upon incomes without apportionment.

5. No other change was effected by the Amendment, and, as to taxation of all classes of property other than incomes, the original constitutional limitations still obtain.

6. The legislature cannot, therefore, impose, without apportionment, a direct tax upon such other property by any enactment which purports to include in *income* any part of the *capital* from which the income is derived; and an arbitrary inclusion of such capital is a taking of property without due process of law, and an appropriation of it to public use without just compensation.

As a result, the sole inquiry in this, as in every case relating to an income tax, is: What is the amount of the net income of the tax payer? and, under the principles above set forth, its ascertainment is a matter of simple mathematical calculation.

The close relationship between inquiries as to what constitutes return of invested capital and what is an allowable deduction by way of depreciation is evident. As respects the result, it may be of little importance whether a certain sum be exempted from taxation because it is conversion of principal and not income, or whether the exemption occur because it is deductible for depreciation. It is submitted, however, that, while the results may be the same, and although it may sometimes be difficult to determine the true rule of exemption, nevertheless, that rule is the true one which distinguishes between (a) the proceeds of capital conversion and (b) the depreciation of capital invest-

ment by wear and tear or obsolescence with no compensating substitute. In any particular instance the duty is imposed upon the taxing officials, in seeking to ascertain the actual income, gains and profits of a tax payer, to observe the distinction referred to.

The extent of depreciation is largely a matter of estimate and opinion; the amount of capital conversion is usually susceptible of almost precise calculation. Where the nature of a business or of a transaction contemplates or requires the specific transference or transmutation of principal assets, a conversion of capital ensues by the substitution, in lieu of the original assets, of the purchase price, if it be sold, or of the property into which it is transmuted,—as in the case of a sale of lands or merchandise; the transference of property under condemnation proceedings; the cutting and removal and sale of timber; the mining and disposition of minerals; or the transmutation, by manufacture, of raw materials into a marketable product; or again, the payment and discharge by the maker of a pecuniary obligation which one holds as an investment. On the other hand, depreciation designates the reduction of value in any form of property resulting from its use, impairment by the elements, destruction by accident, or decay.

It was observed by this court in *Stratton's Independence, Limited v. Howbert*, 231 U. S., at page 420, that it is a matter of little moment as respects the tax to be paid whether the deduction be in one form or the other, and, as was held by the Circuit

Court of Appeals in the *Von Baumbach case* (219 Federal, at pages 43-4), if the allowance be not made in one form, it must be in the other. In either case, the amount is exempt from taxation.

See, also, *Mitchell Brothers Company v. Doyle, infra.*

If the gross receipts for sales of ore be income, it is then material to inquire by what rule depreciation shall be calculated and a brief consideration of that subject follows.

VI.

The allowance for depreciation must be based upon the value, and not the cost, of the property.

By Article 141 of Income Tax Regulations, issued by the Commissioner under date of January 5, 1914, and which is still sought to be enforced, there was promulgated for the guidance of collectors and tax payers this rule:

> "*Art.* 141. The depreciation of coal, iron, oil, gas and all other natural deposits must be based upon *the actual cost* of the properties containing such deposits. In no case shall the annual deduction on this account exceed 5 per cent. of the gross value at the mine (well, etc.) of the output for the year for which the computation is made."

Undoubtedly, the regulation is in accord with the act of Congress, but both, as has been shown, are unenforceable as respects invested principal ,or capital assets, which may be included in royalties, or other selling price received, over and above the arbitrary 5 per cent. allowance.

With reference to the regulation quoted, it can scarcely be denied that the Commissioner exceeded his powers in assuming to fix the basis of depletion by "the actual *cost* of the properties containing such deposits." The proposition that the actual *cost* (and not the actual *value* at the time the Income Tax Law became effective) of the properties containing mineral deposits shall be the basis for computing depreciation cannot be sustained by any

rational argument. The capital investment of any owner of mineral lands on the first day of January, 1909 (when the Corporation Tax law went into effect), or March 1, 1913 (the date to which the Income Tax law purports to relate), was represented by the *then value* of that property and not by the actual cost under a purchase made one year, or many years, earlier by him or by his ancestor for whom the property was inherited. Practically every acre of mineral land in Minnesota was acquired more than a generation ago for timber purposes, and at minimum government prices, and the timber had been removed prior to January 1, 1909. When, also prior to January 1, 1909, the mineral deposits were discovered, an enormous increase in intrinsic value occurred. Such *value*, when ascertained at that or any given date, was the measure of the owner's capital investment in the land at such date, quite irrespective of the actual *cost*.

Von Baumbach v. Sargent Land Co., 219 Fed., at page 37.

Mitchell Brothers Company v. Doyle, infra.

The same principle holds true, of course, of other mineral lands, wherever situated, whether entered as such under the federal mining laws, or originally acquired for other purposes before the mineral possibilities were discovered. The cost is of no consequence whatever, as far as any increment in intrinsic worth before a tax law becomes operative is concerned. The value *at that time* must serve as the basis for determining future

gains or profits by which to measure an excise or income tax.

Indeed, this was adopted as the rule of the Treasury Department under the Corporation Tax Law in respect of mineral properties. In a synopsis of decisions issued by the department February 14, 1911 (T. D. 1675), published for the information of Internal Revenue officers and others concerned, the following rules are found:

> "80. In case of corporations whose business consists in part or wholly of mining, producing, and disposing of deposits of nature (ores, coals, gas, petroleum, and sundry minerals) the conduct of such business will be understood to comprehend two classes of gains or losses, viz:
>
> (a) The gain or loss resulting from the sale of capital assets, i. e., either the increment, or the loss, arising through possessing over a period of time the investment in the same.
>
> (b) The trading or commercial gain attached to the conduct of the industry, the employment of working capital, the effort and risk involved.
>
> 81. In the ascertainment of net income deduction will be allowed for depreciation arising from exhaustion of deposits of ore, mineral, etc., and for depreciation and obsolescence of improvements, in accordance with general regulations respecting depreciation allowances, on the basis of the original capital investment cost of the properties concerned to the company reporting.
>
> 82. *A further deduction will also be allowed, through not including the same at all in the item of gross income (item 3, Form 637), for the unearned increment represented in such properties as at January 1, 1909,* which will be determined in general as follows:

83. An estimate should be made as of January 1, 1909, of the fair market value *at that date* of the minerals, etc., in deposit. This estimate should be formed on the basis of the disposal value of the minerals *in total* and exclusive of values of improvements and development work. This valuation should also be reduced to a unit value—per ton, barrel, etc.

Note—Values as aforesaid should not be estimated on the basis of the assumed saleable value of the output under current operative conditions, less the actual cost of production, because, as hereinbefore stated, the selling price under such conditions comprehends a profit both for carrying the investment in minerals, improvements and working capital, and for conducting operations in respect of production and disposal of product. The value to be determined as stated must be on the basis of the saleable minerals considered *en bloc*, if disposed of in that form. Nor must such valuation comprehend any speculative value which might attach to a sale of the minerals *en bloc*, i. e., a value which might be obtained on the ground that the future would develop a much greater reserve of mineral deposits than were believed to exist at the time estimate as of January 1, 1909, was formed. Any value of this latter character would attach obviously to such additional reserves when developed in future.

84. *The unit value as of January 1, 1909, ascertained as above outlined, would indicate the value to be attached at that date to the capital assets disposed of during any calendar year succeeding, and should be used in determining the unearned increment at January 1, 1909, which may be excluded entirely from the item of gross income, as before explained.*

85. The precise detailed manner in which the estimate of value of minerals, etc., *as at January 1, 1909*, shall be formed, must naturally be determined upon by each corporation interested, but formal record of such estimates,

together with all sustaining information, should be carefully filed so as to be readily accessible for reference. Values as stated, *as determined at January 1, 1909,* should be used in compilation of all subsequent years' excise-tax returns. The question as to whether it subsequently develops [that] the property possessed a greater quantity of mineral, etc., reserve than was in the aggregate estimated as of January 1, 1909, is immaterial. *Any excess which may be developed will be considered as possessing the same value at January 1, 1909, as that which then may have been known to be in the property.*"

If those treasury decisions were right, as matters of law, the rules promulgated therein must be equally applicable to the Income Tax Law, and the calculation of values as at March 1, 1913 (at the earliest), must serve as the basis of determination of the volume of *capital* embraced in gross income of a mine owner, instead of an arbitrary percentage of the gross value at the mine of the yearly output.

That this is true is demonstrated by the suggestion that any increase in the value of a mine prior to February 25th, 1913, could not be taxed without apportionment, even if conceded to be income. The 16th Amendment is prospective only in its operation (*Shreveport v. Cole*, 129 U. S., 36), and Congress acquired no power thereunder to tax income previously accrued. Its authority affected only incomes derived in the future.

Mercur, etc., Mining Co. v. Spry, 16 Utah, 222.

Centennial, etc., Mining Co. v. Juab County, 22 Utah, 395.

Mitchell Brothers Co. v. Doyle, Collector.

In *Mitchell Bros. Co. v. Doyle, Collector*, decided in U. S. D. C. Western District of Michigan, 2nd Division, April 30, 1915, and not yet reported, the opinion discloses that a lumber company, in 1903, acquired certain properties then valued at $2.25 per thousand feet for standing, merchantable, hardwood timber, $8 per thousand for pine timber, and $2 per acre for cut-over or stump land, at which prices the properties were carried on the books of the company. After their purchase, through natural and other causes, the properties increased materially in value. In its excise tax returns for the years 1909 to 1912 the company deducted from the gross receipts for timber converted into lumber, and for stump lands sold, as being return or conversion of capital assets, an amount which was admittedly no more than the fair market value of such timber and land at the time of the incidence of the excise tax. The Commissioner of Internal Revenue allowed, as a deduction from gross income, the original cost, as above stated, but assessed an additional tax against the corporation equivalent to one per cent of the amount of the increase of value over cost which the company had deducted. This additional tax was paid under protest and suit brought to recover it, and judgment was entered in favor of the corporation for the sum claimed. In the course of its opinion (from which, since it is not yet available for reference in the Federal Reporter, we quote freely), the court said:

> "The plaintiff claims that its standing timber and other property were capital assets, and that the portion of the proceeds derived from

the cutting, manufacture and sale of such timber, measured by the actual stumpage value thereof, did not constitute income and, therefore, that, in computing its taxable net income, it was entitled to deduct such actual stumpage value of its timber from its gross receipts. The commissioner of internal revenue concedes the right of the plaintiff to deduct the original cost price of the timber, as shown by its books, from its gross receipts, but denies its right to make any deduction on account of increase in values. The attorney general contends that all the proceeds derived from the manufacture and sale of the timber constituted income, and that plaintiff, in its returns of taxable net income, had no right to make any deductions whatsoever on account of either cost price or actual value of the timber stumpage.

The proofs in this case show conclusively that between the time of their purchase in 1903 and the first day of January, 1909, when the Excise Tax Law became effective, plaintiff's timber, lands and other property had so increased in value that they were fully worth the amounts which were deducted from gross receipts as capital assets. It cannot be denied that the plaintiff's standing timber was a part of its capital assets and that the conversion of the timber into lumber and the sale of the lumber constituted at least an indirect sale of the timber and so of capital assets. The mere change of the timber into lumber or money did not transform capital into income. The miller who grinds his stock of wheat into flour and sells the flour does not thereby destroy or impair his capital and convert it into income. The same is true of the manufacturer who converts his cotton into cloth, the land owner who sells his lands for cash, the furniture maker who transforms lumber and other material into chairs and tables, the ironmaker who produces steel rails from iron ore, and every industrial institution where raw materials are converted

into finished or other products or into money. In each instance income is and must be something over and above the original capital investment plus the cost of production and sale. This rule has been uniformly recognized by the commissioner of internal revenue in the decisions and directions issued from his office for the guidance of the collectors of corporation excise taxes and of the tax payers themselves.

Standing timber is as staple a product as wheat, cotton or iron. It is a tangible and visible property, whose quantity, quality and market value can be readily ascertained and determined. In these respects it is wholly unlike mineral ores in place under ground. If plaintiff had sold its standing timber on the first day of January, 1909, at its market value, could it be claimed that any part of the proceeds of such sale constituted taxable income because more was realized than the original cost in 1903? Certainly not, for the reason that the increase in value had accrued prior to the time when the Excise Tax Law became operative. If plaintiff had purchased its timber thirty years ago from the government, at $1.25 per acre, and had manufactured all of it into lumber and sold the lumber during the year 1909 at market prices which prevailed on the first day of that year, could it be claimed that the entire proceeds of the lumber above the trifling purchase price of the timber and the cost of manufacture and sale constituted taxable net income? Can the government, at least in the absence of specific legislative declaration to that effect, reach back years before the enactment of its revenue statute for a controlling factor in determining the net income of a corporation? Can it ignore a substantial increase in value of property which has occurred and accrued prior to the taking effect of the tax law, and thereby convert into income that which is not income within any meaning of the term? To state these questions is to answer them. * * *

Tested by another well-settled rule that the gain, profit, or income of a corporation is that which may be withdrawn or expended without reducing the value of its property or impairing its capital, the contentions of the government must fail. Every tree cut from the lands of plaintiff after January first, 1909, and manufactured into lumber, cord wood, or other products, and then sold, reduced its property and capital by the exact amount of the value of such standing tree unless an equivalent portion of the proceeds of the sale was substituted therefor. The government is not concerned with the gains made, profits earned, or income received, whatever their form, by the plaintiff prior to the time when its tax law became operative. Whether a valid retroactive law could be enacted need not be determined because no attempt has been made to tax such gains, profits or income. * * *

What has been said of timber converted into lumber, cord wood and other forest products, and then sold, applies with even greater force to plaintiff's stump lands and city lots. There was no intermediate transformation of the real estate into other forms of property before its sale. According to the proofs, the lands were sold and converted into money at no more than their actual market value on the first day of January, 1909. On that date they were capital assets and the moneys thereafter derived therefrom did not become taxable income."

It will be observed that the contentions of the appellant here advanced are sustained by Judge Sessions in the following particulars:

(1) Ores, lands or standing timber owned by a corporation are a part of its capital assets, and the conversion of them into money, or their transmutation into other forms of property, is a conversion of capital assets.

(b) The change of form, whether into money or other property, does not change capital into income.

(c) Income is something produced by capital without impairing the capital, but leaving it intact.

(d) The value of capital assets at the time the taxing law becomes effective—and not the original cost thereof—represents the invested principal which must be left intact. The government is not concerned with gains made, profits earned, or income received prior to the time its tax law attaches.

(e) In the absence of specific legislation to that effect, the government cannot reach back before the enactment of a revenue statute and, ignoring a substantial increase in value which has accrued prior to the taking effect of the law, arbitrarily convert into income the increased worth of a tax payer's assets.

Every business man and corporation, presumably, prepares a balance sheet at the end of each fiscal year, showing, on the one hand, resources, and, on the other, liabilities. The resources are arrived at by an annual inventory, and the gain or loss of the business is determined in accordance therewith. The Income Tax Law was adopted and approved October 3, 1913, and, by its terms, relates back to the first day of March, 1913, at which time the enactment of such a statute was not in contemplation. The business man or corporation making his inventory as of February 28, 1913, would count among his resources the value *on that day* of the tangible assets of the business. Any gain or profit in such assets over the cost thereof, no matter during what period preceding the gain had accrued, would be an integral part of the business resources

at the time of the inventory. The status of the individual or corporation, as respects commercial or banking credits, would be based upon the capital assets determined by the inventory, and it would be the extreme of absurdity for anyone to assert that such assets did not represent the invested capital of the business. Having such a capital, the tax payer can well protest against a dictum, either by Congress or by the Commissioner of Internal Revenue, which arbitrarily discounts business resources, and dogmatically declares that the money permanently invested in business is not a part of its capital.

This brief is not intended to embrace any discussion of the power of the Congress to pass an income tax law which shall be retroactive in its operation; that power is obviously open to serious doubt, and, if it exist and be exercised, it can result in incalculable injury to the public. For the purposes of this argument, it is assumed that it is within the power of the Congress to make the provisions of the Income Tax Law apply to conditions existing as of March 1, 1913.

It is submitted that the *value* of any property, as such value existed on the first day of March, 1913 (at the earliest), including any advance over *cost* (the "unearned increment" of the Commissioner's regulations), fixed the basis of computation of the income tax under the law of 1913.

VII.

HOW DO THE CONCLUSIONS NOW ARRIVED AT AFFECT THE CASE AT BAR?

The Baltic Mining Company, on the first day of January, 1909, possessed capital assets of $30,000,000, of which $2,000,000 represented the plant, machinery and equipment, and the remaining $28,000,000 represented *the then value* of 800 million pounds of copper, the valuation being based upon an estimated life of the mine of forty years with an average rate of removal of 20 million pounds of copper per year; the copper was, therefore, worth, in place, at the date named, 3½ cents per pound. When mined, the yearly output of 20 million pounds is valued at $3,000,000, or 15 cents per pound; the expenses of operation average 8 cents per pound, or $1,600,000, leaving a surplus, above expenses, of 7 cents per pound, or $1,400,000, of which one-half represents the conversion of capital into money, the remaining one-half being the gains or profits from the operation. $700,000 of the annual receipts are, therefore, capital which can be taxed by the Federal Government only in accordance with the rule of apportionment. The other $700,000 of annual receipts (being the gains or profits of operation) are reducible, before being taxed, to $600,000, by a deduction for depreciation of plant, machinery and equipment which, under the admitted facts, is 5 per centum of $2,000,000, or $100,000.

If it be not granted that the sum of $700,000 is exempt from taxation as being capital converted from ore into money, then that amount must be deducted from the $1,400,000 of net receipts as and for a reasonable depreciation of capital assets by depletion of the ore deposit in the mine.

In either case then, instead of an income tax upon $1,400,000 per annum, the government can validly lay and collect, under the act of October 3, 1913, a tax upon $600,000 only.

It results that the action of the District Court for the District of Massachusetts dismissing the complainant's bill in this suit cannot be sustained, and the judgment must be reversed.

The Income Tax Law of 1913 will, of course, govern, in the same manner, the liability of other mine owners operating their own properties.

VIII.

HOW DO THE CONCLUSIONS ARRIVED AT AFFECT MINE OWNERS WHO HAVE DISPOSED OF, OR MAY HEREAFTER DISPOSE OF, THEIR ORES UNDER MINING LEASES OR OTHER FORMS OF CONTRACT?

Those proprietors of mining properties who, prior to March 1, 1913, had already disposed of their ores, to be mined by their vendees, are manifestly exempt from the payment of any income tax upon the moneys received by them for such ores, because, the fact of the disposition at a specified price of itself demonstrates the value attaching to the ore at the time of its disposal. All possible gains over original cost had then been realized and had become capitalized. The owners had sold their property for so much.

Mitchell Brothers Company v. Doyle, supra.
Von Baumbach v. Sargent Land Company, supra.

Regardless of any future change in mineral values, the price which the owners can receive during the term of the mining contracts (and it will be remembered that such contracts are made for terms sufficient to permit the exhaustion of the ore deposits) will remain fixed, and no increase above the price specified in the contracts (which can be reckoned as gains or profits in the nature of income) is possible to the owners. The moneys paid to them, at the specified and unchangeable rates named, represent the purchase price of ore which they have

sold, and, as such, when received by them, constitutes the equivalent in money of the ore in place in the ground. When the ore deposits shall be exhausted, the owners will have, in lieu thereof, the royalties which have been paid to them in the installments provided for in the mining contracts, and they will have nothing else. This is shown by the statement of this court in the *Howbert case*, to the effect that the sale outright of a mining property may be fairly described as a mere conversion of the capital from land into money (p. 414). A sale which gives the vendee the absolute right of possession and removal of ore is "outright" regardless of the time of payment.

Von Baumbach v. Sargent Land Co., 219 Fed., 38, 39.

Stevens v. Hudson's Bay Co., 101 L. T. Rep., 96.

Secretary of State for India v. Scoble, 89 L. T. Rep., 1.

Foley v. Fletcher, 3 H. & N., 769.

Hence, it being manifest that the mere postponement of payment of part of the purchase price—its discharge in installments instead of one lump sum—cannot affect the question (resulting in the necessary conclusion that in such cases royalty payments are capital and not income receipts), an exaction of taxes on account of them, except in the manner prescribed by the Constitution, cannot be upheld.

Looking then at the substance and not at the form, it is seen that the 5 per centum depreciation clauses in the Act of October 3, 1915, are mere in-

effective legislative fiats as to what, for the purposes of taxation, shall be deemed income, under which, where the depletion exceeds 5 per centum of the gross value of the ores at the mine, an exaction is attempted in violation of the rights of tax payers and of the several states which the Constitution so carefully recognizes and guards. Of the protection of its limitations nothing will remain if they can be thus easily and openly evaded.

IX.

CONCLUSION.

It is, accordingly, respectfully submitted that that portion of sub-paragraph Sixth of Paragraph B of the Act of October 3, 1913, which provides that, in computing the net income of individuals for the purpose of the normal tax, there shall be allowed as deduction, in the case of mines, "a "reasonable allowance for the exhaustion, wear "and tear of property arising out of its use "or employment in the business, not to exceed "5 per centum of the gross value at the mine "of the output for the year for which the computation is made," and the similar clause in respect of the income of corporations contained in paragraph G (b) sub-paragraph second, providing for a deduction from the gross amount of the income of a corporation of, "in the case of mines, a "reasonable allowance for depletion of ores and all "other natural deposits, not to exceed 5 per centum "of the gross value at the mine of the output for the "year for which the computation is made," are in violation of clause 3 of Section 2 of Article I, and of clause 4 of Section 9 of Article I of the Constitution, as well as of the 5th Amendment, and cannot, therefore, be lawfully applied in determining the true *net income* of any tax payer, which net in-

come alone the Congress has any competency to assess under the Income Tax Law of 1913.

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